UNIVERSITY OF MADRAS

SOME TRENDS OF MODERN PUBLIC FINANCE

With Reference to India

Sir William Meyer Lectures, 1934

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BY

K. V. RANGASWAMI AIYANGAR,

UNIVERSITY OF MADRAS

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TO

SIR P. S. SIVASWAMI AIYAR, K.C.S.I., C.I.E., LL.D.,

IN VENERATION AND GRATITUDE

CONTENTS.

PREFACE.

The Government of India Act of 1935 received the Royal Assent on the 2nd August last. The lectures now published were delivered about a year earlier, between the 23rd and the 30th July, 1934. They were designed as a contribution to the discussions then proceeding on the financial principles to be adhered to in the revision of the constitution of British India and in the determination of the relations of British and *Indian* India. Through various causes it was not possible to send the following pages to the printer before the end of June last. By that time the drift of the settlement was clear. The new constitution contains features not in accord with recent fiscal opinion. The inclusion in the lectures of any examination of the financial implications of the new legislation would have necessitated the rewriting of many parts of the book. To do so in a preface would have made it unduly lengthy. But neither course seemed necessary, as a study of the financial sections of the Government of India Act in the light of the relevant passages in the lectures would enable a reader to see how far the former were in accord with the accepted trends of modern public finance.

The following pages accordingly represent the lectures as originally composed eighteen months ago, with a few corrections and amendments made in deference to suggestions and criticisms with which I had been favoured in the interval. My obligation in this respect is most heavy to Sir Sivaswami Aiyar. From his writings and speeches I have long drawn inspiration and guidance. At a time when his health was far from satisfactory, he read through the lectures

and favoured me with his views and comments. He has since added to the debt by allowing me to inscribe the lectures to him.

I have also received much help both in the preparation and in the revision of the book from Mr. N. S. Narasimha Aiyangar, M.A., B.L., and my old pupil, Mr. A. N. Krishnan, M.A., L.T.. Dr. P. S. Lokanathan, M.A., D.SC., (ECON.) not only helped me with his advice and criticism on many points, but generously saw the book through the press and prepared the index. Two former pupils, Mr. A. Sattanathan, M.A. and Mr. K. R. Padmanabha Aiyangar, M.A., B.L., have collected for me some useful statistics. More than one emendation is due to the suggestion of my colleague, Dr. Hans Raj Soni, D.SC., (ECON.) whose knowledge of Indian Industry is wide and accurate. But in acknowledging my indebtedness, I should also state that the responsibility for every statement made in the following pages is entirely mine.

BENARES
HINDU UNIVERSITY,
25th December 1935.

K. V. RANGASWAMI.

I.

Public Finance in the New Order.

Politics and Economics—Present attitude in India.

India is on the threshold of great changes. Expectation and disappointment are struggling in the political field. Since the momentous pronouncement of August, 1917, which declares autonomy within the British Empire as the end of Indian political development, and as the culmination of the successive constitutional schemes of Britain in regard to India, considerable progress has been made in our political experience, education and outlook. Indian opinion is therefore disappointed with the slowness of constitutional advance, and irritated by the repeated attempts of the forces of re-action to retard India's approach to the goal. The attention of the best minds of the country is being directed exclusively to political reform. This is inevitable. In a dependent country, in which good government is still only the gift of an administration not responsible to public opinion, progressivist criticism attributes all evils to the absence of a responsible executive. Issues in debate are narrowed to a few points so as to ensure the necessary degree of concentration in attack. This procedure has two consequences. On the one hand, the Government is reluctant to undertake reform in the social and economic spheres for fear of presenting a wider front to nationalistic attack. Indigenous opinion on the other hand adopts an equally narrow attitude and holds that the attainment of autonomy should precede that of other ends. Conse-

quently, questions which concern the commonweal, which are not less important than political improvement, are overlooked by both sides. It is not realized that this narrow outlook, if persisted in, will bring almost simultaneously with autonomous government a depletion of resources and economic backwardness and stagnation.

The left wing of Indian politics has yet to put forward a comprehensive scheme of social and economic development. Independence is claimed as the goal of India, but it is narrowed to the freedom which consists in mere protection against external control. The wider freedom of equal opportunity for all within the country is not yet a part of the national porgramme. Not only has there been no conscious striving to secure it to the masses, but there has been a tendency to stabilise and even intensify the economic inequalities which now obstruct its attainment.

This can be illustrated. One of the demands of the Indian nationalists has been the extension of the Permanent Land Revenue Settlement to every part of India. The avowed object of the reform is not the removal of that degree of the patent inequality between Zamindari and Ryotwari lands, which has sprung from the liability to re-settlement of the latter, and the immunity of the former. The landlords of Bengal to-day have an unearned surplus, estimated at 12 crores, which is the result of the economic progress of the last 140 years. The extension of the Permanent Settlement to the rest of India cannot immediately level up the position of the ryots in those areas, and bring the land-owners there to the standard of the Bengal landlord. This is admitted by the advocates of the reform. The offence of the Permanent Settlement is held to lie not in its fiscal

unwisdom, but in its application to parts and not to the whole of India.

Similar is the attitude to the revival of the Cotton Excise duty in the interests of revenue, now that the old improper discrimination, which was justly condemned, is removed. The repeal virtually gives a bounty to capitalist concerns, which had hitherto been liable to the duty. In the absence of foreign competition, the re-imposition of the excise duty may indeed raise prices to the consumer, but the protection against foreign competition is now obviously at his expense. As long as the excise duty is imposed without prejudice to the degree of protection that may be required by an industry, the opposition of the nationalist is misdirected.

A third illustration may be found in the nationalist plea for Prohibition,[1] in the sense of a total suppression of the drink evil. The advertised ideal ignores or conceals several relevant facts: the futility of attempts to abolish drinks without taking effective steps to get rid of the drug-evil; the vast sacrifice of revenue involved, which amounted in 1926 to about a seventh of the total revenue, and in some provinces, *e.g.*, Bihar, to nearly two-fifths of the provincial revenue; the virtual impossibility of enforcing it, without incurring a colossal expenditure and creating a huge preventive force, and subjecting people to the suffering involved in interference, on a vast scale, with personal liberty.[2]

[1] In February, 1927, Mr. V. Ramadas Pantulu moved a resolution in the Council of State recommending prohibition in the areas directly administered by the Central Government. The Government amendment, narrowing it to moderation of consumption, was carried. Bombay, Madras and the United Provinces have accepted "abstinence" as their ideal, and the Central Provinces has declared the ultimate extinction of country-made spirit as its goal. In 1927, a local option bill was passed in Assam.

[2] Prohibition was ended in the U. S. A. in December, 1933. For its enforcement $25 millions was used annually, and in 1928, the Federal Commissioner for Prohibition claimed that not less than $300 millions

The Indian nationalist is usually a confirmed protectionist. An indiscriminate advocacy of the protection of industries, which compete with foreign undertakings in catering for the consumption of the common people, must, if agreed to, lead to further burdens being placed on the over-weighted shoulders of the poorer consumers, and in many cases the sacrifice cannot be set off against an assurance of starting prosperous national industries.

It is a natural defect of the existing political system of India that popular criticism of Government measures should be of a negative and not of a constructive character. Government and the people are habitually viewed as occupying opposite camps. This attitude is in accordance with the tradition of the atomistic individualism of Herbert Spencer. It is also natural, and perhaps even inevitable, but is unfortunate, as it accentuates the feeling which suspects all Government action, regards both taxation and Government as necessary evils, and seeks a steady reduction of the area of State intervention and taxation. Legislative criticism from parties, which are not likely to be called on to implement their views by being invested with authority to replace those who are criticised, is bound to be weak in a sense of responsibility.

Its effect on Indian Finance.

In the sphere of Public Finance, this attitude has had two striking results. Such Indian opinion as

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would be needed every year for the enforcement of the law. During 12½ years of its existence (up to June, 1932), Prohibition was responsible for the conviction of half a million people, and the arrest of ¾ million, and for the collection of fines aggregating $75 millions. (*Encyclopaedia of Social Sciences,* XII, pp. 499-510, 1934). By 1923, in 3 years, the accumulation of prosecutions on the files of the courts had mounted to a figure which it would take 50 years to clear (*Indian Taxation Enquiry Committee's Report,* p. 185).

claims to be progressive is focussed on alleged extravagance in administrative expenditure and ruinous taxation. It endeavours to justify its demand for the large sacrifices of tax revenues by proposing of drastic cuts in expenditure. The reduction of the salt tax, the loss of income which would follow the extension of the principle of Permanent Settlement, extinction of the revenue from drink and drugs, and the revision of the Income-tax and of the Land tax, so as to allow of wide margins of exemption for efficient family upkeep, are all to be balanced by bringing military and administrative expenses down to the level, which is urged as sufficient for India's needs and consistent with her economic capacity.

The Government is content to reserve the right to impose additional taxation, and to keep down pressure, by raising only the amount of revenue needed to keep the machine going. The 'security services', the public debt, and the central administration are to be safeguarded, and the cost of their upkeep is to be met by collecting an adequate revenue with the minimum of friction. In attempts to discover ways of raising the necessary resources without provoking opposition, fiscal experts in India have evolved methods and technique of great efficiency and ingenuity. Their object, seems to be, in Colbert's phrase, "to pluck the goose with as little squealing as possible". They might quote with unction and conviction, as James Wilson did in 1860 and Sir Auckland Colvin in 1886, Burke's famous saying—"It is difficult to tax and to please, as it is to love and be wise". In the result, the expenditure on the vast scale needed for *effective* national development is now neither demanded by the representatives of the people nor considered by the Government. Conservatism has become a fiscal virtue, and caution a habit.

Indian Finance—Its defects.

At its best, this is only fair weather finance. It is weak against sudden blizzards. The attempt to balance the budget and produce a nominal surplus leaves no reserves which could meet even ordinary miscalculations, much less unforeseen vicissitudes. This is a cardinal defect of our financial system, as Sir Walter Layton pointed out.[1] A fall in the exchange value of the Rupee, or a delayed or a deficient monsoon, upsets our financial equilibrium. Our high public credit enables unforeseen deficits to be met by temporary borrowing; unanticipated surpluses of appreciable size are concealed and expended on capital undertakings, which should not be financed from revenue. Such a system affords little scope for broad views, embracing a sweep of years, and for a planned sequence of steady growth in resources, effected by comprehensive development schemes. It also fails to visualise the vital bearing of the fiscal system on the prosperity of the country. Taxation has far-reaching, and often obscure effects. So has public expenditure. Either can advance or retard the free growth of the resources of the people according as it is wise or unwise, and its unseen effects may often be more important than those which are visible on the surface.

The system of finance in India has, in addition to its traditional conservatism, some features which have been impressed on it by history. It chiefly relies on forms of 'direct' taxation such as the Land Revenue, which have not much to recommend them except tradition. It indeed uses 'indirect' taxation along with the 'direct', but in a manner which sins against equity. The

[1] See his Memorandum, *Report of the Indian Statutory Commission*, Vol. II, p. 208 and p. 218.

owner of even a minute fragment of land, who has no other resources, is now taxed, both on his land and on articles essential to his life.[1] Unforeseen and unintended discrimination in favour of the affluent and against the poor often result from the use of direct and indirect taxes without reference to one another, and from the effects of the great Government undertakings, which are virtually monopolies. The remodelling of our fiscal system, so as to secure an equitable distribution of the tax-pressure, and prevent the weakening of productive capacity, now arouses the opposition of powerful interests, which have come to enjoy 'unearned' advantages. Improvements in our system of finance are rendered difficult by the existence of interests, which it has itself established. The necessity for fiscal reconstruction is, however, one which cannot any longer be denied, delayed or ignored. Our economic ideals cannot withstand influences which are now powerful throughout the world. An efficient bureaucracy in some ways responds to changes in economic outlook and method more readily than a democracy. The unparalleled strain of the War, and the disappointment which followed the expectations of prosperity, have focussed attention upon finance and banking, and given them a world-wide importance. The fiscal diseases of no country are at present its exclusive concern. Like epidemics, in the control of which every nation has an equal interest, the prevention of vicious and unstable fiscal policies is now the concern of all nations equally.

Importance of Fiscal Science.

Public Finance, considered as a branch of study, has in recent years acquired an importance, which it

[1] The practice is logical. When even the indigent are tax-bearers under a scheme of food-taxes, the owner of even a minute field cannot ask for exemption from the payment of land revenue, on the ground that the minimum of subsistence should go free.

has not possessed since the Napoleonic wars. Originally regarded as a part of Political Science, and still treated as a border-land subject, it is receiving the attention and care which frontier territories receive. The theoretical bypaths of Public Finance have been explored. The problems of 'incidence' have been studied with minuteness. Vital questions like the interaction of fiscal and monetary policies, and the limits of public expenditure have received much attention. Public Finance is coming to be viewed both as a disciplinary and an utilitarian study, whose object may be either "light or fruit, either knowledge for its own sake, or knowledge for the sake of the good things to which it leads".[1] Both these aims of scientific investigation are demonstrated in the investigations of problems now undertaken by leading economists.[2] This is only natural. Economic well-being indeed depends on the *whole* system of Law, including the laws of property, contract and bequest, and not merely on the law about taxes; but the interactions of Finance and Society disclose the paramount importance of fiscal schemes. "Nations seldom realise till too late," declared W. H. Lecky, "how prominent a place a sound system of finance holds among the vital elements of national stability and well-being, how few political changes are worth purchasing by its sacrifice, how widely and seriously human happiness is affected by the downfall or perturbation of national credit or by excessive, injudicious and unjust taxation."[3]

The War, its immediate and persistent effects, and the World crisis from which we have not yet emerged,

[1] A. C. Pigou, *The Economics of Welfare*, 1924, p. 3.

[2] Cf. *Economica* November, 1934, pp. 436-459, *Review of Economic Studies*, 1934, pp. 18-31.

[3] W. E. H. Lecky, *Democracy and Liberty*.

have all served to emphasise the need to re-examine financial systems, and to discover ways and means to enable States not merely to tide over present troubles but to protect themselves against great vicissitudes in future. The financier has come to his own. The priority formerly given to the diplomat and the soldier is now assigned to the Finance Minister. The economist is called in to assist the administrator. In the giant schemes of National Planning, which are now in operation, theory receives its due importance side by side with administrative knowledge and experience.

The scrutiny of current fiscal systems shows how they are often unscientific and unsystematic, and are survivals of antiquated policies or are the results of the efforts of dominant interests. Every fiscal system is conditioned by the social aspirations and the political ideals of its age. The ideals, which are now in the air, are largely the corollaries of our *milieu*. The War sapped the foundations of Conservatism. The aftermath of the War weakened faith in the classical theories of Society and Finance. Many fiscal ideas which were once considered axiomatic, are now subjected to drastic criticism. New interpretations are put on old conceptions like "taxable capacity", "equity in taxation", "financial equilibrium", and "equality". A modern Finance Minister has to take note of the changes and suit his plans to the altered view-points.

Implications of the New Order.

In India, the need for such a change is both immediate and imperative. The attitude which was content to regard the Government of India as a mere tax-gathering agency, not very different from some of its unregenerate predecessors, must give place to one which would realize the implications of democracy and federa-

tion. Political equality cannot be firmly based on economic inequality. The attack on privilege and position, and the retention of power by select minorities, must lead to reduction of vested interests. Plans for the recovery of the submerged continent of human depression in the Indian population will fail, if they overlook the necessity for *economic* uplift. The gift of self-respect is not to be despised, if it will kindle the spark of self-reliance in persons hitherto in virtual servitude. But the only enduring foundation for it is freedom from poverty and from the evils that property implies. Plans for the removal of 'untouchability' as well as the grant of equal social opportunities and of access to temples, public wells, and highways to the depressed classes, are all welcome, but they are not sufficient to bring about any considerable amelioration of their condition. They cannot by themselves produce the widespread national solvency, on which the future financier should build, so long as schemes for the reduction of poverty and the waste of natural and human resources are not made the prelude to political and social uplift. Economic planning must *precede* and not follow social reform and political emancipation. The postponement of the economic rehabilitation of the nation to a vague future when India will have a full-fledged democracy, and a responsible executive, is an inversion of logical and historical relations.

Such are the implications of the New Freedom and of the demands for Constitutional Reform. It is one of the disabilities of India to-day that political enfranchisement is not paralleled by economic, and that the two have been moving at such different paces that economic forces are unable to overtake the political. Unless this is corrected by an acceleration of the *tempo* of economic development, a position of unstable political

and fiscal equilibrium will probably be reached along with, or even before, the advent of full Responsible government.

Legislative control is the natural safeguard against bad finance. The advocacy of direct taxation, in preference to indirect, usually rests upon a belief that the effects of the former are more conspicuous than those of the latter. Additional expenditure of public funds and the provision of necessary extra resources will depend in the future, more than at present, on legislative sanction, particularly in the provinces. "For the future, the House will have to share our responsibility. If we incur expenditure it will be under your mandate. If we impose taxation, it will be by your vote". These words of Sir Malcolm Hailey, in the Legislative Assembly in 1921, constitute perhaps, now as then, with the wide powers of certification reserved for Government, rather an aspiration than a statement of the actual constitutional position. Nevertheless, it is the admitted goal. In a democracy, the sanction to collect or expend money will be granted readily, only when the electorate, in which the power is vested in the ultimate resort, is able to discriminate between good and bad finance, and is sufficiently educated to accept the burden of additional taxation as the means to the attainment of benefits which though real and large are neither immediate nor visible. This is why the fiscal education of the people must proceed at the same pace as their political education. The big issues in regard to the public debt, revenue and expenditure must be clarified, and the people educated by the Government as well as by organised political parties, to understand them. It is a defect of present day politics in India that there exists no provision for this work. Finance continues to be treated as the occupation of

economists, Government departments and the legislative *elite*. The duty of giving form and substance to the policies outlined by the legislatures devolves upon the Government. The smooth working of the financial machine is also a responsibility of the Government. In a country with an expanding suffrage such easy running can be assured only by the creation and maintenance of an electorate sufficiently intelligent to appreciate measures of finance.

An obligation to create and keep alive in the people an intelligent interest in fiscal matters lies on the great national parties no less than on the Government. The appeal of financial programmes must be directed to the people, whose welfare they affect. The parties of the future should have clear financial policies, look far ahead, and plan long-period fiscal programmes. Constructive schemes should replace the monotony of indiscriminate condemnation of Government measures. Our New Freedom should connote not only our *right* to manage our own affairs but also the *duty* to do so in such a manner as to secure a larger measure of social justice than at present. The habit of attributing all existing evils,—poverty, 'black-coated unemployment', disease, illiteracy, famines and disunion—to the existence of a foreign executive must give place to clear views of the ways in which, when India gets full autonomy, it will be used to reduce and to root out such evils. Our fiscal system must be made *rational* as well as *national*. In its essentials it should be above party. It should aim at distant as well as immediate returns. To make a financial forecast of any country even ten years in advance is a highly speculative undertaking';[1] and, in the case of India the attempt is hazardous on account of the

[1] Sir Walter Layton—*Report of the Indian Statutory Commission*, Vol. II, p. 252.

number and complexity of the factors making for uncertainty. Nevertheless, the attempt must be made, and the apparatus of planning so improved that accurate forecasts are possible.

When the appointment of the Indian Taxation Enquiry Committee was announced in the Legislative Assembly in 1924, it was resisted, though the Government disclaimed any intention of seeking additions to the existing tax burdens, and also declared that the enquiry was only meant to discover ways of improving the fiscal administration and making the incidence of taxation more equitable. The nationalists contended that the limit of taxable capacity was already reached, that economic enquiry into the condition of the people should precede the taxation enquiry, and that the latter must also be put off in view of the complexity and cost of the economic investigation, which could not then be taken up. Even moderate opinion in the Assembly was against the proposal from a feeling that it would be unwise to provide additional revenues to the Government, as the result of a subsequent discussion of the recommendations of the Committee, without first securing the opportunity to overhaul the whole system of public expenditure, civil and military, along with an adequate control over the entire field of expenditure. The attitude was not perhaps unreasonable, when considered in relation to the manner in which the discussion was sought to be narrowed by the Government to taxation proposals only. It is a matter for poignant regret that the Assembly was not afforded an opportunity for a full discussion of the fiscal position in the light of the findings of a valuable enquiry. The attitude was responsible for the subsequent shelving of the Taxation Enquiry Committee's Report, when it was placed before the Legislature two years later (1926). It is possible

that if India had then been obliged to face the terrific stress of Western nations, who have had to finance War debts, reparation payments and recovery measures, even a report on mere *tax* reform, excluding questions of public expenditure, would not have been so shelved.

India's political freedom is an essential constituent of the new World Order. The grant of it will be as much a boon to the Empire as to India. It is vain to deny that there are many who now regard the British Empire with ill-concealed hostility and even profess to see in it a menace to world peace. A free India, taking her place willingly among the Dominions, may not abate such ill will or envy, but she will reduce the risks to the Empire from such feelings. The grant of Dominion status to India will also prove an effective reply to the challenge of renascent Asia.

To a free India, lasting security is not possible till she gets an up-to-date financial system. The implications of freedom go much further than the removal of external control. Social peace requires the removal of economic evils, such as glaring inequality. In the constitutional scheme which it put forward, as an answer to the challenge of Lord Birkenhead, the Nehru Committee proposed the appointment of a Commission of Enquiry into the sources of revenue which may be assigned to the Central Government and to the Provinces, after the establishment of the Commonwealth.[1] The proposal implied an indefinite postponement of the question, even when a federation was looming in sight. A federation ordinarily results from a conviction of reciprocal advantage. Unless the financial position of the provinces and the Indian States is previously clarified and expressed in well considered schemes, and is accepted

[1] All Parties Conference, 1928: "Report of the Committee to determine the principles of the Constitution of India," p. 97.

by all parties, even the idea of a federal union will be unwelcome. This was the procedure followed by the Round Table Conference, the Peel Committee, the Percy Committee, the Davidson Committee and the White Paper of 1933. At the moment, the prospect of a Federation seems to melt in the haze of a receding future. Anyhow, whether federalised or not, progressive British India will require that political issues should not be allowed to keep back the solution of outstanding financial problems. Our constitution-makers must be gifted with political as well as economic vision.[1]

Postulates of the New Finance.

In the preparation of financial programmes for India it will be necessary to give weight to considerations of various types. It will be well to recognise first that anything which might govern the pace at which India advances towards autonomy is not directly relevant to the settlement of her financial policy. Solvency is essential to all forms of government. Secondly, it is neither necessary nor desirable to limit the purview of a proper scheme of finance for India to the changes in the constitution which are considered imminent. The need for improvements in our fiscal system has arisen from the economic situation *within the country.* Full autonomy may not result in immediate internal peace as well as economic prosperity, unless its attainment follows or coincides with the removal of the root causes of Indian poverty, unrest and stagnation.

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[1] "Now-a-days money and not the sword is the ultimate source of power in all reform, and the ultimate sanction of all authority. All other particulars of good Government profit the State little, unless its system of public finance is well-designed, well-understood and well-protected and maintained. The last two needs depend much upon the second unless the system is well-understood by an instructed public and the financial administration is constantly illuminated by the light of public opinion, there is danger that its methods might lapse into mere routine and inefficiency, and that the administration may be tempted to take liberties".—(E. Hilton Young, *System of National Finance,* p. 6).

India's fiscal programme must therefore be viewed not in isolation but in its relation to plans of social reconstruction. It should form part of a scheme of economic and social planning, and include the provision for such planning. The mental isolation of India is now disappearing fast, and the Indian mind is beginning to respond to changes in world opinion. Recent movements within India have demonstrated the baselessness of the hypotheses of Indian fatalism, of the incurable spirit of resignation of the average Indian, which is supposed to make him acquiesce in the perpetuation of hard conditions of life, and of his overpowering sense of unworldliness or other-worldliness. The helplessness of the Indian villager is indeed a fact, but it is due to causes partly economic, partly social and only faintly psychological.[1] The masses sunk in poverty do not need to be instructed to enable them to realise its glaring injustice. The recent attempts to secure some measure of social equality for the "depressed" classes have attracted attention to the more fundamental inequalities of economic conditions. Socialism is in the air in India, and the Indian peasant is learning to think in its terms.[2] Even apart from these considerations, it will be impossible for the governments of the future to overlook the duty to raise the condition of the people, and to remove the causes which make for social and political disequilibrium. In view of the position of dependence in which the masses of India still remain, and of the narrowness of the suffrage for the next thirty years at least, the Government and the intelligentsia must undertake the work of social

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[1] The Royal Commission on Agriculture, and *India in* 1924-25, pp. 236-241 appear to stress unduly the psychological bases of Indian poverty.

[2] The significance of the recent peasant movements in the United Provinces and in the Circars in the Presidency of Madras should not be missed.

amelioration.[1] This task does not require external stimulus or the propagandist activity of the Socialist group, which is just raising its head in Indian life. We are moving far from the position which dreaded the price to be paid by *lavish* expenditure on social services, for the removal of the backwardness of a whole people, and which regarded such expenditure as weakening the strength of the country to withstand any unforeseen emergency. The trend of the times is to belittle such arguments for national solvency. It is generally forgotten that State activities in social amelioration must be financed by taxation or by loans, which also involve taxation, spread over a long term of years, that there are limits to taxation and to borrowing which are set by the economic strength and the public credit of a country, and that it would be unwise to destroy the sense of security in the tax paying citizen and the confidence of the investor in public loans. The need for caution used to be urged by financiers of the eminence of Earl Cromer, and there are still many who hold such a view to-day, though they are generally treated as out-of-date. The old argument that the comparatively lighter taxation of England contributed to the economic strength which enabled her to bear the prolonged strain of the Napoleonic wars, is now met by the contention that England would have been even more successful, had she adopted by the end of the 18th century the plans of social betterment which she undertook a century later. Modern opinion bases the real financial reserve on the affluence and contentment of the people, and holds that nothing which would pro-

[1] The Government of India have, since the delivery of these lectures, made a grant, which may be regarded as a beginning in rural reconstruction, by giving a crore of rupees for the purpose in 1935-36. The Indian National Congress anticipated the measure by its scheme of village uplift.

mote both wealth and general welfare *can* be fiscally unsound. But, is popular contentment synonymous with productive efficiency, and is a general levelling up through State action, the certain means of increasing the national dividend? Sidgwick saw the point of such questions, when he objected to Socialism not on the ground that it would divide the produce of industry badly but for the reason that it would leave so much less to divide,[1] and showed that the real objection to the removal of the causes of economic inequality is productional and not distributional.[2] It is now urged that recent experience has dispelled the fear. The modern view was better stated by Dr. Marshall: "Any diminution of inequalities, which can be attained by means that would not sap the springs of pure initiative and strength of character, and would not therefore materially check the growth of the National Dividend, would seem to be a clear social gain". "It is one of the incidents of inequality, that genius that happens to be born of lowly parentage must expend itself in lowly work. No extravagance is more prejudicial to the growth of national wealth than that wasteful negligence. . . . The economic value of one great individual genius is sufficient to cover the expenses of the education of a whole town." Forty years ago, Dr. Marshall pleaded on *economic* grounds for legislation to fix the minimum standards of housing, food, cleanliness, and healthy surroundings for children and of an education very much higher than was then available to the bulk of the people.[3] Even to conservative economists of to-day, who refuse to recognize in taxation an instrument of social reform (*e.g.*, Sir J. Stamp), the prospect of an improvement in the econo-

[1] H. Sidgwick, *Political Economy*, 1901, p. 516.

[2] *Ibid.*, p. 505.

[3] Alfred Marshall, *Principles of Economics*, 8th edn., p. 216.

mic capacity of a people by such wide planning as will add to productive capacity and remove the barriers to equitable distribution, has a powerful appeal. At the same time some modern advocates of social reform refuse to put their trust in financial panaceas, like the single-tax, and would look (like Prof. Seligman)[1] for the remedy for inequality "in the slow gradual evolution of the moral conscience of mankind." But, a conviction of injustice is rarely efficient as a motive power of reform, unless it is reinforced by the power to devise and execute schemes of economic re-construction. The bigness of the undertakings as well as their difficulty may justify the reluctance to undertake them, but the hesitation will be overcome and the risk faced when it becomes clear that only planning on a vast scale can attain the end.[2]

The world of to-day has lost many old beliefs in the domains of Economics and Politics, which were potent in the 19th century. The social changes which had taken place even before the outbreak of the War, have helped to usher in the new outlook. The War proved an effective solvent of many old dogmas. The amazing recovery after the War was followed by an appalling and universal slump from which the world has not yet emerged. These events have destroyed some and modified other 'Victorian' ideas. Fifty years ago, Sir William Harcourt caused a stir by his rhetorical declaration: "We are all Socialists now". No similar emotion is likely to be caused now even if it is claimed that "we are all Bolsheviks". There has been a fundamental change in viewpoint. To the financier, the focus of attention is now not the individual but the community. International co-operation has produced new modes of international thinking. Intellectual co-operation between

[1] E. R. A. Seligman, *Essays in Taxation,* 1925, p. 94.

[2] J. S. Mill, *Political Economy,* Bk. V, Ch. 2. 'The difficulty of doing perfect justice is no reason against doing as much as we can'.

peoples, the promotion of which is on the programme of the League of Nations, is steadily increasing. Modern thought, wherever it might originate, spreads its influence over the world, by passing through the clearing houses of the Universities, the Press, and the Broadcasting agencies. Advanced Socialist views are now expounded officially by University teachers, who thirty years ago would have had no academic footing.

Auxiliaries of Fiscal Reform: Planning.

Three forces of inspiration and guidance are now available to the modern fiscal reformer. We have first the records of the financial history of modern States during the past thirty years. The experiences of the post-War period, and particularly of the last decade, are of considerable value. We have, side by side with it, the views of many living economists, who have subjected old doctrines of Public Finance to minute analysis and examination, and who, in the process, have arrived at conclusions which are in better accord with present day Economics[1]. We are privileged to watch the progress of National Planning on vast scales, begun under government initiative, direction and control in two great Republics, separated from one another by half the breadth of the globe and by a difference in cultural level nearly as wide. Italy, China, Turkey and Manchukuo

[1] The discussions of shifting and incidence in Public Finance have been less affected by recent work in the field of prices than is generally supposed. "It seems doubtful whether the writings of Alfred Marshall have been given the consideration they deserve. The studies of demand curves by statisticians, such as Ezekiel and Schultz, the conception of the bulk-line producer developed by Taussig and Secrist, the importance of overhead costs as factors in price determination, emphasised in the writings of J. M. Clark, and the new studies of imperfect and 'monopolistic' competition are full of suggestions to the student of Public Finance. It is, however, fair to state that while the recent efforts of students of prices raise doubts as to the adequacy of the marginal analysis, they have not succeeded in establishing in its place a generally accepted theoretical frame-work." (Prof. R. Murray Haig of Columbia in *Encyclopaedia of the Social Sciences,* XIV, 1934, p. 537.)

have plans in view. Mexico, Germany, Sweden and the Irish Free State are contemplating plans, comprehensive or partial. The primary aim of such plans is either remedying accumulated deficiencies or speeding up the satisfaction of the economic wants of the country. These experiments, initiated and pursued with somewhat different aims, and under circumstances and difficulties which perhaps obscure their permanent effects, are full of instruction, particularly to countries like India, in which the problems to be solved, judged by the magnitude of the numbers involved, are equally big.

The opponents of Planning urge the merits of the existing economic order, and ask what higher advantages Planning can bring. The relative value of Planning and the continuance of the existing automatic regulation of economic activities, through the Price-medium, have been conveniently summed up by Sir Arthur Salter:

"The distinctive merits of the automatic system are the enormous stimulus it gives to productive capacity and the greater elasticity of the response which the consumer secures to his desires and caprices. The defects are, the waste involved by irregularities of demand, and consequent interruptions of production and sale.

The planning system has the opposite defects and qualities. It provides a weaker normal stimulus to productive capacity (although that may be for a period supplemented by the desire to win a war or the enthusiasm in establishing a new plan), but it tends to utilise what resources and productive capacity are available more regularly and to distribute such supplies as there may be in a shortage with less injustice. We tend to find the planning system in operation, therefore, where resources and productive capacity are limited and the urgent need is to utilise them fully and to distribute what is produced so as to reduce intolerable privation to a minimum."[1]

The normal regulator of economic transactions in the world now is Price or Price-movement. It helps to ration resources and to determine what should be produced as well as how to distribute the goods already produced. Somewhat less perfectly and efficiently, it governs the distribution of labour between different uses,

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[1] *Recovery*, 1933, p. 14.

and the amount of national saving through the rate of interest. But, state attempts at price-regulation are viewed with disfavour because of their risks in a capitalist economy.

The main difficulties in such an economy arise firstly from the mistaken forecasts of produce, leading to shortage or glut, secondly, from the inefficiency of the monetary system, and thirdly, from the growing rigidity of the capitalist society. "But, more important, if temporarily less conspicuous, even than these difficulties, there lurks in the background an unescapable conflict between the individual and the whole society, which must always condemn the purely individualistic type of economy to a practically low level of achievement".[1] Those who emphasize such difficulties would prefer to do away with the capitalist regime altogether, in the interests of effective planning and social amelioration, and substitute socialism for capitalism.

Requisites of Planning.

The conditions of successful Planning may be discovered *a priori* or gathered from the experience of countries in which it has been attempted.[2] First among them comes the knowledge of its principles, and the ability to use it, *i.e.*, the direction of Planning should be in the hands of experts. Only second to knowledge is the necessity for the directing agency to possess a high standard of administrative competence and integrity. A central authority to draw up the Plans and supervise

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[1] Barbara Wootton, *Plan or No Plan*, 1934, p. 162.

[2] On Planning,—see also *World Economic Planning*, 2 vols. (The Hague), 1932; J. A. Hobson, *From Capitalism to Socialism* (Day to Day Pamphlets. No. 8, 1932); Colin Clark, *Economic Planning in the Modern State*, 'Political Quarterly,' II, 1931, pp. 531-547; G. D. H. Cole, *Economic Planning*, 1935; *Collectivist Economic Planning*, ed. F. A. von Hayek, 1935; Boris Brutzkus, *Economic Planning in Soviet Russia* (Eng. trn., 1935); *Planning for Employment* (Macmillan, 1935).

the execution is also vital. The Executive in the United States and the Planning Commission, as well the Gosplan,[1] in the U. S. S. R., are good examples. In order that it might succeed, a Plan must have the country behind it, with all its organs, central and local, urban and rural. There should also be adequate permanency to a Planning agency. In a democratic constitution, the Plans *in their detail* should receive antecedent parliamentary approval. Planning may not necessarily imply the acceptance of Socialistic views of distribution. It is possible in a capitalistic regime.[2] It is also independent of the forms of government, though not of the strength and efficiency of Governments. It does not require international co-operation though, in view of trade and industry crossing national frontiers, a nation with a Plan, which desires to retain its external trade, must perforce follow certain political and economic canons, which will protect it against foreign retaliation.[3] Sir Arthur Salter would go so far as to maintain that no Plan can succeed, which does not reckon in terms of money-prices, and allow prices to bring about adjustments as in 'unplanned economy'. The view is naturally challenged by Socialists, who refer to the somewhat inconclusive results of Soviet planning. But, it is agreed on all sides that the Achilles' heel of Planning is the human factor. Planning *may* succeed even in the absence of natural and technical advantages, if it can only count upon a responsive population, but it will fail, in spite of the inherent soundness of its schemes and all technical

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[1] Gosplan is the abbreviated Russian name for the State Planning Commission of the Council of Labour and Defence, constituted in 1914. It is an advisory committee of experts, subordinate to the STO, or Council of Labour and Defence, which has to frame the Plans. It deals with the New Economic Policy, NEP. The GOELSO is the State Commission for Electrical development.

[2] Socialists deny it. "Planning need not wait on Socialization." (Sir A. Salter).

[3] Barbara Wootton, *op. cit. pp.* 303-352.

aids, if, as *perhaps* in the United States, it provokes widespread opposition. Planned Economy is now becoming a fashion. Recent works are full of suggestions for it, even in old countries like Great Britain, and many plans have been worked up in detail.[1] Measures of partial 'planning' are even more common, as they appear to avoid the extravagance of wholesale national planning. Dr. Hugh Dalton would for instance be content to nationalise Transport and Oil, control all land and private finance, impose an inheritance tax, create a National Development Fund and, for the purpose of promoting productive efficiency and reducing unemployment, diminish the hours of labour, reduce the age-limit for superannuation and raise the school-leaving age. Another recent writer[2] advocates only the establishment of an industrial Board with powers similar to those of the Bank of England. A third[3] would prohibit the export of capital, place all foreign trade under Government control and have an International Clearing Association to deal with Foreign Exchanges and prevent the evils of speculation. Planning has furnished powerful support to the advocates of State control and initiative in industry and trade.

Planning and Liberalism.

Is national planning wholly consistent with the fundamental conceptions of Liberalism? The fact that Planning has come to stay has stimulated an enquiry into this question. The Liberal is now ready to defend regulated production of basic mineral factors, on two grounds. Firstly, the conservation of primary

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[1] Mr. Lloyd George's Plan, which was announced since the delivery of these lectures, illustrates the point. Sir M. Visvesvaraya has outlined an elaborate Planned Economy for India in a recent treatise, bearing this title, also published after the delivery of the lectures.

[2] L. Potter, *A Businessman's View of World Depression*, 1934.

[3] A. G. Macgregor, *Lasting Prosperity*, 1934.

resources is necessary in the interests of society as a whole; and, secondly, monopolist conditions are certain to spring up in the large-scale enterprises, which deal with mineral deposits, and such concerns will need public regulation in the interests of the community. The reconciliation of the basic principles of Liberalism and Planning is further helped by the discovery that in most basic industries, the so-called competitive structure has, in fact, given way to planning during the last forty years, and that the regulation of monopoly has become a normal part of Government activity. The conclusion is accordingly reached that the general concepts of Liberalism are not inconsistent with an extension of regulated monopoly to transportation, and to the production of oil, coal, metals and electric power. Social development commits the Liberals to continuous redefinitions of the limits of private property. Most of them will now admit that the State must be a participant in social processes, and that it is impossible to accept the idea of a self-regulating society which excludes the State as a factor of progress.[1]

Recent Plans: Russia and America.

[2]The two countries in which bold attempts have been made at Planning are Russia and the United States of America. The declared aims of the former are to raise the level of production and standards of life, to produce a classless society, and to make the country economically self-sufficient. The Russian problem is thus one of

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[1] See Professor Abbot Payson Usher's stimulating presidential address—*A Liberal Theory of Constructive State Craft*—before the American Economic Association, 27th December, 1933. (*American Economic Review*, 1934, pp. 1-10.)

[2] See *"Russia, U. S. S. R.,"* ed. P. Malevsky-Malevitch (Payson, N.Y., 1933) and particularly the chapters on the Five Years' Plan by the editor, (pp. 343-373) and on Finance (by Prof. A. Marakov, pp. 495-541).

uplift and levelling. In the United States, President Roosevelt[1] has inaugurated vast measures for the purpose of bringing about a recovery from the grave crisis in American agriculture, industry and trade. He has been "striving, by rush tactics and with great political skill, to secure a return of prosperity and confidence, by raising prices, production and purchasing power in parallel lines".[2] These measures constitute a wholesale interference with the working of the capitalist system though they have not attacked capital itself. For the purpose of carrying out the Recovery programmes the President has had to be invested with powers more vast than those which any executive has received except in the stress of War. "The outlook for its success is not free from doubt, but however it ends, it will be judged a very gallant effort." A distinguishing mark of the Roosevelt programme, in contrast with that of the Soviet, is that the former is not intended to be permanent. It is restricted to *recovery,* and must end automatically when the object is achieved.

Considerable misapprehension still exists in regard to the purpose and results of the two Five Year Plans of the U. S. S. R. In some measure it is due partly to the frankness with which the Soviet authorities have published accounts of their failures and disappoint-

[1] He has himself described the way in which the measures were inaugurated in *"On Our Way,"* 1934, which recounts the story of his first year as President. The 'New Deal' professes to combine the 'Square Deal' of President Roosevelt and the 'New Freedom' of President Wilson. The former claimed to establish a partnership between Business and Government, and the latter attempted to correct the abuses of Business by public control. The New Deal is not Fascist, because it draws its inspiration from the mass of the people rather than from a group, and because it maintains the republican constitution. It is not communistic, since, in spite of the superficial resemblance furnished by a driving regimentation, it does not aim at the abolition of private property or at the total elimination of any economic class. *See also* Ernest K. Lindley, *The Roosevelt Revolution, the First Phase,* 1933, p. 239 and p. 287.

[2] H. Dalton, *Unbalanced Budgets,* 1934, p. 9.

ments, and advertised their readiness to alter or re-adjust their plans, and partly to prejudice generated by the harshness of the earlier Communist regime. Allowing for failures and for the cardinal defect[1] (which one of the Russian leaders, Molotov, indicated), success in certain directions is indisputable. Russia has become a land free from unemployment, which has been 'planned away'.[2] There has been astonishing industrial and agrarian progress, resulting in vastly increased productive capacity, at a time when there is diminution everywhere else in Europe, and the increase bids fair to be permanent and progressive. Russia claims to have come within measurable distance of a classless equalitarian society. Her work for the depressed and backward communities has been notable for its humanity and success, and should provide in that respect useful guidance to those attempting a similar task in India. Though the Russian standard of living is still generally low, the Soviet has provided for the common people cultural and social amenities the like of which is not to be found for common folk even in the advanced countries of the world. Russia is becoming economically self-sufficient, and is likely to be one of the biggest exporters in the world, when her huge power-generating installations are fully in operation.[3]

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1 "In the Soviet union the whole is planned and every detail is chaos, whereas in the rest of the world every detail is planned and the whole is chaos"—Statement ascribed to Stalin, quoted by Mrs. Barbara Wootton in *The Burden of Plenty*, p. 100.

2 As a sample of adverse criticism of Soviet planning (inspired by disbelief in Marxism and in the possibility of planning in a market-less and non-monetary economy, *see* Boris Brutzkus, *Economic Planning in Soviet Russia*, ed. F. A. Hayck, 1935, *passim*. Even Brutzkus admits that in the heavy industries and in the preserved food industry there has been marked success (p. 200 ff.), that 'more care is taken of workers in large cities' (p. 218) and that 'the number of workers has been doubled' (p. 226).

3 "*Twelve Studies in Soviet Russia*", 1932, *passim*.

The Roosevelt Recovery Plan calls for attention chiefly by its comprehensive and ordered character, its constitutional and popular backing, its single-minded resolve to attain its ends, and the relentlessness with which it is being put into operation. Its financial commitments are stupendous,[1] and are justified by reference to the existence of a "national emergency", necessitating special measures and sacrifices. This emergency is declared to undermine internal and foreign trade, standards of living and public welfare generally, to give rise to every form of unfair competition, to cause widespread unemployment, to fail to utilise to their full capacity the productive capacities of the nation, to lower consumption levels by diminishing purchasing power, to depress agriculture, and to lead to the shrinking of the volume and the efficiency of national transport. The measures of recovery are said to be specially designed to correct specific types of unfair competition which are to be destroyed by insisting on the licensing of all businesses and by compelling them to disclose to the President their production and marketing methods and to modify them according to the President's direction. Unemployment is to be corrected by Labour Codes providing for collective bargaining and the fixing of the maximum hours of work (at thirty a week) and the minimum of wages, by comprehensive schemes of Public Works, anticipating the commitments of future years,

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B. Brutzkus (*op. cit.*, p. 205), however, contends that "the quantitative expansion of industrial production is to a large extent set-off by the fall in the quality of the goods produced." He also asserts (p. 207) that "the productivity of labour in Soviet Russia, in spite of the most modern machinery, lags far behind the productivity of labour in other countries."

[1] The *initial* provision was itself, as *infra*, and it has been greatly extended since. Certain taxes were imposed, and the Treasury was empowered to borrow the necessary sums under the Liberty Bond Act. The President was authorised to purchase market securities up to $3,000 millions, and to issue additional paper currency up to $3,000 millions.

and by housing and slum clearance schemes. Agriculture is to be helped by placing most of the chief products under national regulation, and by loans to farmers to help them to purchase stock and farm implements and to clear their debts. Transport is to be controlled and improved, including the pipe lines which convey mineral oil. Public Works are to be started on a colossal scale, mainly to develop backward areas. Trade is to be supervised. The President is to issue Notes and coin silver to any extent.[1] The magnitude of the financial commitments is seen from the appropriation of 3,300 million dollars for N. R. A. measures, 2,000 million dollars for refinancing farm mortgages, and from grants ranging from 25 millions to 500 millions each for such purposes as the redistribution of the industrial population, for the orderly liquidation of joint-stock Banks, for helping farmers to pay up their debts, for providing farm capital and for unemployment relief. The N. R. A., exclusive of its Labour and Public Works sections, contemplates a thorough-going recasting of the anti-Trust policy in the United States of America. It has been acclaimed or condemned as inaugurating a revolution in economic theory and practice.[2] Even its critics admit that the N.R.A. "Codes" offer possibilities of eliminating *some* methods of unfair competition.[3] But, the N.R.A. itself establishes State

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[1] *See* the enactments collected in *National Recovery Measures in the United States*, Geneva, 1933 (International Labour Office).

[2] As samples of the criticism which the New Deal provoked at the time, see the *Round Table*, September, and December, 1933, which described the N.R.A. as "the great experiment in unfreedom, so noble in motive, so disappointing in accomplishment".

[3] See *Economics of the Recovery Program*, by Seven Harvard Economists, 1934, p. 62. Prof. J. M. Clark (*American Economic Review*, 1934, p. 21) concludes: "We are on safer ground if we regard the Act (except for the Public Works programme, which is attached to it) not as a means to stimulate immediate recovery, but rather as partly a measure to substitute work-sharing for relief, and partly as a means of controlling the quality of a recovery already begun, with a view to putting it on a

monopoly in place of private monopolies. Its provisions to remove the evils of child labour have been commended.[1] But the distinction made between the agricultural, industrial and other relief measures, overlooked the organic interdependence of the different elements of national economy and betrayed the artificiality of the scheme.[2] The New Deal, exhibited many features which were not economically sound. The support which it has received furnishes an index of the enthusiasm for uniting and rationalising business efforts. It is a sign of the strength of the new movement for co-ordinated schemes of development under direct state control in place of the old chaotic individualism.

Planning for Britain.

The large expenditure required for comprehensive schemes of national development is only possible to states. This will account for the advocacy to-day of many schemes which savour of 'planning'. We may take a sample. Mr. Colin Clark in treating of the control of investment[3] specifies as the *immediate* social needs of Great Britain a number of items of expenditure, such as building working-men's houses, putting up and renovating school buildings, rural water-supply and public health generally, afforestation, railway

sounder and more enduring basis". *See also* Sir Arthur Steel—Maitland's "*New America*", 1935, *passim*. His verdict is—"America is bound to recover" (p. 196).

[1] *Economics of the Recovery Program*, by Seven Harvard Economists, 1934, p. 84.

[2] *Ibid.*, p. 153. Mr. J. M. Keynes in his "Notes on the New Deal" contributed recently to the *New York Times* objects to its restrictionist philosophy, outside agriculture, which requires adjustment, its complexity and regimentation, and condemns the price-fixing provisions. He urges the wisdom of the Recovery expenditure not being allowed to go below $400 millions a *month*. He estimates the improvement in output already achieved at 15 per cent. which extends to income and employment.

[3] New Fabian Research Bureau, *Pamphlet* 8, 1933.

electrification, planting industrial or urban population in satellite or garden cities, regional planning, etc. The enormous sums required for all this reconstruction are to be obtained by prohibiting the exportation of capital from the country and by an efficient co-ordination of the industries and the money market. For this end, the Bank of England is to be nationalised. A National Investment Board, on non-party lines, manned by experts, is to be established. The function of the Board will be to control investment, prohibit the issue of tempting prospectuses, which attract capital to undesirable undertakings, and protect ordinary folk from being victimised by company promoters. The Board is also to finance invention and promote private saving by the grant of a rebate of income-tax to the industries in which such savings are invested. It is to draw its resources from additional taxation, till such time as it has resources of its own, built up from the earnings of the nationalised concerns. The bare outlines of Mr. Colin Clark's scheme will show the vast effort he envisages, though not one bigger than what Great Britain had to undertake during the War. "To plan for peace," contends Mr. Clark, "is not more difficult than to plan for War"

The Planning idea in India.

These schemes have been described at some length as they should interest India to-day. Planning has become a vogue.[1] A plea for its adoption in India has been urged in the Legislative Assembly first by the European business group of the Central Legislature. To the popular side, which concentrates its fire on the

[1] Since these lectures were delivered, the Indian Economic Conference, which met at Patna in December 1934, discussed at some length the arguments for and against Planning for India. See the Proceedings, in the *Journal of Indian Economics,* XV, 1934-5, pp. 362 ff.

character of the present administration, the European group's advocacy of Planning may have induced suspicion. Other circumstances would emphasize the hesitancy. There is a widespread feeling in the country, almost amounting to conviction, that when the Government has been flush of resources, they dissipated them on the Army, on liberal grants to the already overpaid foreign elements in the higher ranks of the public services, and on schemes like the construction of New Delhi and the reclamation of the Back Bay area at Bombay. With such a feeling in the background one may anticipate some popular reluctance to the acceptance of big schemes of development expenditure, to be met from taxation or from loans, and to be executed by Government agencies. But, the pressure of circumstances and the growth of opinion in economic circles must soon create a favourable popular attitude towards Planning, and it will be recognised that the inelastic revenues and rigidity of normal expenditure leave India only one way to lead her out of the economic labyrinth, namely, the promotion of an all-round development, which will increase *pari passu* both the resources and the taxable capacity of the people. At any rate, Planning cannot be well delayed much longer than the advent of autonomy at the Centre.

India's Facilities for Planning.

In some respects, the conditions of India may appear to give special facilities for the starting of Planned Economy.[1] In spite of its great size, India is a geographical unit and is compact in area. Its vast population is a potential asset. It has a strong executive, with experience of designing and carrying out vast works of public utility. Its public services enjoy a

[1] The conditions of Russia and India in regard to their fitness for adopting Planning suggest resemblances.

reputation for efficiency and integrity. There is a well-established tradition of the people looking to the Government for all measures that would promote national welfare. The growing bias is towards State ownership and management of enterprises like the railways, airways, telephones, etc. Many departments of the State are expert in large scale operations like famine relief, the control of epidemics and the management of public utilities. The War experience has left a tradition of rationing, regimentation and control. Its wealth in minerals and forest produce should help to make India economically self-sufficient, if only its resources are carefully husbanded and developed, and the necessary key-industries are established within her borders. The trend of democracy in India will help rather than hinder an extension of State activity, as the objection is not to Government control but to British domination.

Its difficulties.

These are distinct assets for Indian Planning. But, there are also difficulties, peculiar to India, which should be neither overlooked nor made light of. There is no homogeneity in the population, which culturally is of uneven levels; and is divided by conflicting religious, political and social ideals. The existence of Indian States, scattered throughout India, and of different standards of political and economic efficiency, furnishes another impediment, which will become a veritable obstacle, if they come into an Indian Federation on *varying* terms, as the result of individual bargaining. There is an evil tradition of communal and religious ill-feeling and rivalry, which has tended to promote disunion. The centrifugal tendencies are emphasised by the existence of caste and class. Continuity of policy is rendered difficult by dependency on the British Parlia-

ment and by the periodical changes in administrative personnel. Indian administration is weakened by the quinquennial Viceroyalty. If the Governor-General of India had no more authority in the Constitution than the Governor-General of Canada, and the permanent Civil Service in India had the same self-effacing, non-communal disposition and character that the permanent British Civil Service has, there would be more chance of continuity in policy. An official hierarchy, whose higher ranks are filled by persons of non-Indian domicile, and "big Business" controlled largely by foreign capitalists, will both continue to repel popular trust. The reluctance to embark on large scale Plans can be overcome gradually but only with the enfranchisement of Government and its Indianisation, and with an increasing perception of the width and depth of the gaps in the structure of national life, which can be bridged over by Planning alone.[1]

An Apologia: the Founder.

These preliminary considerations may indicate the importance and the timeliness of a review of the trends of the theory and practice of modern Finance in relation to India. The choice of the subject for a course of lectures, given under an Endowment reflecting the love of Sir William Meyer for the country which he served virtually all his life, may have a special appropriateness derived from his own associations. Among the Finance Ministers of the Crown in India, from the days of James Wilson downwards, Sir William Meyer will always occupy an eminent position.[2] His lot was cast in the anxious times of the war, when he was called upon to face suddenly new situations created by it. He

[1] See Lecture VI, *infra* for the financial implications of a Twenty-year Plan proposed for India. Sir M. Visveswaraya (*Planned Economy for India*, 1934, pp. 295-298) has furnished an estimate of the cost of his Ten Years' Plan for India. It appears to err on the side of inadequacy.

[2] The administration of the East India Company was notorious for

faced them with courage, skill and unfailing resourcefulness. He managed the financial machine with firmness and dexterity. He had to restrain his own inclination towards financial reform. Reforms need money, and the imposition of additional burdens on the tax-payer was unthinkable when 'a war was on'. His administration was memorable, notwithstanding the difficulties he had to encounter. He was the first Finance Member of India to give effect to the principle that it is to the advantage of a country, to keep as much of its public debt as possible in the hands of its own people. He deliberately preferred Rupee loans to Sterling loans, and used the Postal Savings Bank extensively to stimulate habits of thrift among the less affluent classes, and to direct their small savings to profitable uses. The Post Office Cash Certificates, which he introduced in 1917, have become a permanent and popular feature of the Indian credit system. India has been accustomed to financial stringency, at definite periods every year, when the pressure on many banks is greater than their resources can meet, and at the same time large balances remain idle in the Government treasuries and reserves. Sir William Meyer recognised that lending to banks during such periods was of reciprocal advantage. He not only averted a banking crisis in India during the War, but gave a fillip to trade and industry. It is true that in spite of his outlook and conviction, he declined to sanction even comparatively small grants of 30, 50 and 12 lakhs of rupees respectively, claimed by Indian leaders like Dr. V. S. Srinivasa Sastri, Sir B. N. Sarma and Pandit Madan Mohan Malaviya, for the promotion of primary education, sanitation and industry respectively. To a Minister who easily found 200 million sterling for

its bad finance, and led to Disraeli's mordant remark in 1858: "India, which has produced so many great men seems never to have produced a Chancellor of the Exchequer."

the War, these driblets should have been easy, especially, as in Great Britain itself, where also there was 'a war on' (as Sir William Meyer used to plead in defence of his refusals), Mr. Fisher was able to obtain from the Treasury four millions for education. Sir William Meyer foresaw the possibility of having to tax the income from land over and above its assessment for the Land Revenue. The unanimous tributes to his services when he laid down his high office indicate the appreciation of his success as a Finance Minister. "Sir William Meyer," said Dr. Srinivasa Sastri, whose own demands had been turned down, "has been a tireless watcher of the Treasury as well as of the public weal. Cruel domestic sorrow, exceptional difficulties in office, and criticisms, undeserved and sometimes harsh, have added to his burdens and cares, but through them all he has pursued his duty unflinchingly". The financial expert of the Council, on the non-official benches, Sir D. E. Wacha, acclaimed Sir William Meyer as 'the greatest finance Minister of the day'. His powerful vindication of the greatness of India's direct and indirect sacrifices during the war before a cruel and unjust indictment, touched the heart of India. When India was attacked and compared with the Dominions to its disadvantage, he warmed up in defence: "My Lord", said he, "I do not want to be thought hostile to the Colonies in any way, but I love the people of India. I have served her for a generation and I cannot bear anybody to belittle India". There may thus be a special fitness in a lecturer, speaking on the Foundation, endowed by and bearing the honoured name of Sir William Meyer, selecting for study that branch of Economics in which the Founder excelled, and applying its lessons to the problems of the country, which he served with steadfast loyalty and devotion.

II.

Recent Trends in Public Finance.

Towards Fiscal Reform.

The growing importance of Public Finance in recent times is chiefly due to the conviction in the larger possibilities of public over private action in many spheres of social activity. Economic changes are re-acting on political ideals, and giving rise to sweeping revisions of old views of public revenues and expenditure. The War and the economic crisis, which has come in its wake, have both helped to fix attention upon the magnitude as well as the complexity of the problems of recovery. Among the remedies commonly suggested is combined national and international action for which the necessary resources are to be found from taxation or loans. A decided change in ethical values is also in evidence. It has been helped by the mental re-action to the contrast between the extremes of riches and poverty in modern society. Unemployment on unprecedented scales constitutes an economic disease and a social menace. In the search for remedies for present day evils and for the means of preventing the perpetuation or recurrence of economic misfits, the eyes of statesmen turn to fiscal reform. In some countries, the desire for reform springs from the widening rift between economic conditions and fiscal methods. In others, it arises from a sense of what is due to those in the community who have had less than justice done to them. The movement towards financial reform has also been helped by recognition of the greatly increased efficiency of administrative agencies, and by the demands of modern democracy for

open measures, popular control, avoidance of waste, the fullest utilisation of resources and opportunity, and smoothness of working. Fiscal reform is oriented towards social justice. Tax reform has become a corollary of modern industrialism and democracy.

Looking at taxation from the standpoint of the taxpayer, Montesquieu said: "Taxes can be made heavier as the subject enjoys more liberty; as liberty diminishes, taxation must be reduced. In free states, heavy taxes are balanced by liberty; in despotic governments the lightness of taxes is the compensation for the loss of freedom. In a republic the citizen will pay more heavily because he believes that he is paying himself".[1] Looking at the problem from another standpoint, namely that of the psychological effects of taxation, Rousseau declared[2] that taxes tend to become heavier as the distance between the people and the government increases, that in a democracy, the people feels least burdened, and that it feels less burdened in an aristocracy than in a monarchy. Hegel developed the idea of Montesquieu and contended that in a despotic state the people pay fewer taxes than in a constitutional, and illustrated the proposition by reference to England.[3] Durando (1846) found a justification for such views in a mutual pact virtually established by representative institutions between the ruler and the ruled, through which tax payers find a guarantee for the *right* employment of new taxes, and the creditors of the nation a moral security for their loans. With the Liberal distrust of the State and the conception of taxation as a necessary evil, Ricardo asserted: "If you want peaceful government you must reduce the

[1] *Esprit de Lois,* XVIII, 3, 5, 12.

[2] *Contrat Social,* III, 8.

[3] Cf. also Robert Patton, *Asiatic Monarchies, passim.*

[4] G. De Ruggiero, *History of European Liberalism,* p. 308.

budget".[1] He quoted with unction the 'golden maxim' of J. B. Say: "The very best of all plans of finance is to spend little, and the best of all taxes is that which is least in amount."[2] Victorian Liberalism favoured the simplification of the tax-system and the imposition of direct taxes in preference to indirect, on the grounds that the former were easier to collect, more just in incidence and more educative, for, by emphasising the sacrifice made by the citizen for the community, they would also raise the question whether the services of the State were an adequate return to the sacrifices made by the people.[3]

New Conceptions of Society and State.

We have travelled far to-day from the old Liberal position. Society is now recognised to be, and admittedly is more complex than it was. An Italian writer (quoted by Dr. Dalton) correctly describes the spirit of the change: "The State takes account of interests wider in space and time than the individual".[4] The modern financier rises above the old individualistic views of taxation and expenditure. He recognises the truth of what Wagner asserted (1889) in a form, in which the principle is often cited as an economic law:—

"There is a persistent tendency towards an extensive and intensive increase in the functions of the State. New functions are continually being undertaken and old functions are being performed more efficiently on a larger scale."[5]

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[1] *Political Economy*, Everyman's edition, p. 159.

[2] *Ibid.*

[3] Vide *infra*, Lect. III.

[4] *Unbalanced Budgets*, 1934, p. 47.

[5] A Wagner, *Grundlegung der politischen Oekonomie*, 1893, Bk. VI, Ch. 3. See also A. D. Lindsay's article on Individualism in the *Encyclopaedia of Social Science*, VII (1933), p. 680, and Prof. A. R. Usher's recent address (*American Economic Review*, 1934).

The Government is not now looked on as a mere policeman. A characteristic of the modern State is that its *constructive* functions are steadily expanding. This was noticed by Dr. Marshall[1] as early as the beginning of this century. "The amount of constructive work," he pointed out, "which the modern State is requiring from government is probably growing much faster than its power of getting through its work. This is partly because human life is much larger and more complex than it was, partly because our growing knowledge, wealth and standard of public duty make us less willing to acquiesce in great social ills, and even in discomforts, many of which cannot be handled save by the authority and force of government, and partly because the increased intelligence and probity of government officials, make us willing to take the risks of government intervention in many matters in which Adam Smith and his followers would have truly asserted that such a remedy would probably be worse than the disease."

In this trend one may discover an explanation, or even a justification, for the swollen budgets of our day. So early as 1907, the British Chancellor of the Exchequer (H. H. Asquith) anticipated the lines of future development: "Behind and beyond this lies the whole unconquered territory of social reform which, whether we look at it as a luxury or as a necessity, is in any case expensive. The State has recognised its duty to the child, and no one is prepared to go back on it."[2]

The vastness of public expenditure, which is now a normal feature, is opposed to the Victorian tradition. The older view is well represented in a statement of Sir Henry Parnell, cited by H. C. Adams:[3] "Every particle

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1 *Official Papers*, pp. 396-7. (*Fiscal Policy of International Trade*, 1903.)

2 Sir B. Mallett, *British Budgets*, 1887-1913, 1913, p. 272.

3 *Science of Finance*, 1898, p. 50.

of expenditure beyond what necessity absolutely requires, for the preservation of order and for protection against foreign attack is waste and an unjust and oppressive imposition on the public". This doctrine is not even now a spent force. It is obviously the creed of safety and holds a special appeal to those who distrust governments. Its vitality was evidenced by a protest published in the *Manchester Guardian* only fourteen years ago, over the signature of a number of distinguished statesmen and administrators, who thus condemned the "prodigal" expenditure of the day: "The proportion of Government expenditure to national income is several times as great as it was before the War, *which means* that a far smaller proportion of that income is available for provision for old age, for saving and for business enterprise." The views are in consonance with the canon of Adam Smith[1] that the State should not take more than what is absolutely necessary from the pockets of the tax-payers, and that the untaxed remnant should be left to fructify in the tax-payer's pocket. In defining a Tax, emphasis was accordingly laid upon its being a *diminution* from one's resources. From this it was an easy transition to the position that the aggregate of such deductions by taxation was tantamount to a reduction of the net income of the nation.

The view is obviously untenable, for, public expenditure involves a redistribution of income, a transfer of purchasing power within the society.[2] The productive power of the community, which creates the fund from which the national savings come is obviously capable of being increased by well directed public expenditure, on education, public health, communications and

[1] *Wealth of Nations* (1776), ed. J. S. Nicholson, Bk. V, Ch. II, p. 348.

[2] H. Dalton, *Public Finance*, 7th edn., 1932, p. 206.

nation-building activities. From the individual point of view, an investment in human capital, or in knowledge generally, gives a smaller return than that obtainable from an equal investment in material capital. To the community, on the other hand, the investment in human capital might give a larger return than that in material capital. For, while the power of the machine does not tend to grow, from generation to generation, that of the educated humanity grows cumulatively. Accordingly, there is a recognised need "for the intervention of public authorities to improve economic provisions for the future and to secure a better balance between the component elements." "To promote the growth of material capital at the expense of human capital is mistaken policy."[1] Saving has ceased to be a fetish for many of our day. We do not admire the 'abstinence' of "the generations, which built railways and neglected housing, developed machinery and kept educational expenditure at a minimum", and created material at the expense of human capital, to the ultimate detriment of production and at an appalling cost of human misery.[2]

The great increase in social expenditure in modern states is illustrated by the financial history of England between 1921-1931. Every party in power was forced to realise that the increased social expenditure was only an offset to the burden of fresh taxation falling on the poor.[3]

Public expenditure mounts up in modern states because governments have assumed new functions, whose number and complexity make it impossible for

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[1] Cf. Marshall, *Principles*, 5th edn., pp. 570-571, and 717-718; H. Dalton, *Public Finance*, p. 270. See also J. A. Hobson, *Wealth and Life*, 1930, *passim*.

[2] M. E. Robinson, *Public Finance*, 1922, p. 80.

[3] Joseph Sykes, *British Public Expenditure*, 1921-1931, 1933, p. 53.

private authorities to administer them, *e.g.,* public health, national hygiene. Secondly, it is only when the State undertakes the task that the expenditure can provide a communal and inclusive use of many goods.

Thirdly, the acquiescence in the State's expenditure on many items is a tribute to the efficiency and honesty of public authorities, and to the vigilance of modern audit. "We can trust," said Dr. Cannan in picturesque language,[1] "Edward VII to do for us what we would not have expected from Edward VI". Further, modern constitutions provide opportunities for independent and centralised public audit, and for constant and vigilant criticism of all public expenditure in the legislative bodies. These precautions are of course necessitated as much by the tremendous growth of public expenditure as by an increasing suspicion of the tendency of democracies to lavishness and waste.[2] As the superiority of direct taxation over the indirect is supposed to lie in the effects of the former being more visible and easier to watch, so also the vigilance in regard to large scale public expenditure on development and social services has an element of invisibility which necessitates constant scrutiny. "The price of liberty is eternal vigilance, and the price of individual prosperity is perpetual and zealous criticism by tax-payers of public finance. Economy is the best tax."[3] The conservative view persists in the repeated calls for retrenchment, resulting frequently, in the see-saw of party politics, in

[1] *Economic Journal,* 1908, p. 417.

[2] "Economy once expected to be among the strong points of democracy has proved to be its weakest. Financial waste is worst in the United States National Government, owing to the desire to win votes, and the same evil is rampant in Canada and New Zealand and to a less extent in Australia." Mr. P. K. Wattal gives *six* instances in a year of extravagant proposals made in the Indian Legislature "for vote-catching or selfish purposes." (*Financial Administration in British India,* 1923, pp. 301-2.)

[3] A saying of Mr. F. W. Hirst.

drastic cuts in social expenditure for the purpose of balancing the budget—"the economy stunt," which socialists condemn 'as the extreme form of social folly'.[1]

Inadequacy of Indian Expenditure.

In the trend of modern opinion and practice, India's public expenditure is patently inadequate. "The greater portion of government expenditure is incurred in a way which does not conduce to the economic development of the people, and therefore the expenditure on nation-building departments, which would increase the tax-paying capacity is very small."[2] This statement may appear to contain an apology as well an inadequate view of the national demand for development. The rigidity of the non-productive and obligatory expenditure, which India has to incur, is no justification for stinting on measures, which are demanded by national wealth and welfare. The point was noted by Sir Walter Layton: "In India, it should be possible to stimulate production and to increase the welfare of the people by public expenditure designed to give greater economic security (*e.g.*, irrigation works, improved communications, efficient and varied methods of cultivation, etc.), better physical well-being (*e.g.*, sanitary measures, improved water-supply; etc.) and education. Taxation *may* be the only practical means of creating a better and more secure livelihood. It is both possible and desirable to improve the economic and social conditions of the Indian people by a substantial increase of expenditure on nation-building services and to raise revenues for the purpose."[3] Another defect consists in the wide disparity between governmental expendi-

[1] H. Dalton, *Where Socialism Stands To-day*, 1933, p. 60.

[2] C. N. Vakil, *Financial Developments in Modern India*, 1924, p. 528.

[3] *Report of the Indian Statutory Commission*, Vol. II, 1930, p. 208.

ture *per capita* between province and province. They range from Re. 1-8 in Bihar and Orissa and Rs. 2-5 in Bengal, to Rs. 8-3 in Bombay and Rs. 8-6 in Burma. In quality as well as in amount, the standard of service rendered by the Provincial Governments in India is lower in the *poorer* provinces of India. The areas in which there is the greatest need for improvement are just those which are starved. The differences are due to historical and economic causes. It is usually held that in public as in private finance, a due relation should exist between expenditure and means, actual as well as potential. Accordingly, with separate provinces, which have varying resources, a certain degree of disparity may seem inevitable. But, when they are parts of a common whole, it is the duty of the central authority to level up the differences, and to ensure a minimum standard of social efficiency everywhere, and to guard against a relapse when provincial autonomy materialises. One of the grave defects, which financiers in India must steadily aim at correction, is the absence of equal amenities of life to the inhabitants of all parts of the country.

Public versus *Private Economy*.

Modern fiscal theories follow the old in stressing the essential difference between private and public economy as consisting in the precedence given by the latter to expenditure over income. It is only the enunciation of a logical relation, and does not amount to the suggestion of an impossible relation between the two. The obligation lies heavily on Finance ministers to determine the limits of public expenditure, essential for national safety, well-being and growth, and relate them to the available resources, the collection of which will not react adversely on national wealth and welfare, or internal peace.

The success of modern states in financing big schemes of expenditure, which would have filled their predecessors with dismay, is largely the effect of the alteration of the conception of and attitude to taxation. The view that a tax is an indemnity *or* an insurance, is at least as old as Montesquieu. He said: "Taxation is the part of a citizen's wealth which he gives to obtain secure possession of the remainder."[1] From a merely unpleasant incident in private life, taxation has grown to be the dominating feature of social life. A tax is now looked at not merely from the standpoints of the Government and the subject, but of the community considered as a productive economic *unit.*[2] Few now uphold the old view that taxation is a 'necessary evil'. Wide differences of opinion no doubt exist in regard to the *purpose* of taxation. The very existence of a purpose underlying it is sometimes questioned. The definition of a tax as "a compulsory contribution, levied from a person or persons, for the service of the public powers," which Bastable gave in 1892,[3] was criticised on the ground that destination was not an essential test of tax-character. A tax should include the levies of a reckless autocrat, and it will be an abuse of language to treat the satisfaction of an autocrat's caprice as 'service of the public powers'. The criticism has some force. But, recent theory appears to go back to the position taken by the people of Pennsylvania: "The purpose for which any tax is to be raised ought to appear clearly to the Legislature to be of more service to the community than the money would be if not collected." Under this view, those taxes alone are to be regarded as justifiable, which, when expended, establish

[1] Cited in B. Mallett and C. Oswald George, *British Budgets*, Second Series, 1924, p. 197.
[2] Sir Josiah Stamp, *Principles of Taxation*, 1921, p. 5.
[3] C. F. Bastable, *Public Finance*, 2nd edn., 1895, p. 249.

the superiority of collective over individual uses. This view is implied in many statements. Taxation is a social investment (Seligman). It is social insurance (Chiozza Money). Professor L. T. Hobhouse found the true function of taxation in its securing to society the wealth which is of *social* origin. Lord Snowden asserts: "Taxation must be justified by proof that the revenue derived from it will be used in a way which will promote a larger measure of general well-being." "No country was ever ruined," he adds, "or ever could be ruined by high taxation, provided it is justly levied, and the proceeds are wisely expended. There is a popular impression that taxation diminishes national wealth. The very opposite of it is the fact."[1]

"Taxation solely for Revenue."

The old slogan, "Taxation for revenue only" was a deduction from the political philosophy of established rights. It limited the purposes for which taxes may be utilised to the ordinary upkeep of the Government, and prohibited the use of taxation as an instrument of economic uplift or social reform. It derived its support from the distrust of the State, which took the form of a clamant demand for the reduction of public intervention to the minimum, and for the adoption of a policy of laissez-faire. It has been wrongly attributed to Adam Smith.[2] The corollary that "taxation should be low," was put forward on grounds of political expediency, an important argument in states in which the Government does not enjoy the confidence of the people. Lord Cromer's advocacy of low taxation for Egypt, on the ground that it would bring general tranquillity in its trail, was on this ground. So was it in

[1] *Labour and National Finance,* 1920, p. 39.

[2] Sir J. Stamp, *Principles of Taxation,* p. 179. Adam Smith had suggested fiscal expedients for many measures of progress.

regard to the East India Company, which provided for no developmental expenditure in its budgets. The conception of taxation as an instrument of social reform roused the ire of Newmarch in 1852, and it continues to provoke administrators like Mr. A. W. Mellon[1] even in our own times.

Taxation for Social Reform.

This position has now been abandoned. Taxation is accepted as a potent instrument of social reform, even by those, who do not go the length to which Lord Snowden did, when he urged that the "instrument of taxation must be *deliberately* used for the purpose of effecting a better *distribution* of wealth."[2] A wordy battle has raged round taxation conceived as an instrument for reducing economic inequality. The Labour and Socialist defence of the view is briefly as follows. A considerable part of the wealth and income now enjoyed by private individuals is due to their exploitation of the community.[3] Pending such changes in the system of property, and in the relations of capital and labour, as would prevent private appropriation of *unearned* wealth and income, the instrument of taxation should be employed to intercept for the State at least a portion of this wealth for the purpose of raising the standards of life of the dispossessed classes.[4] Another justification for the view is that in all productive activity, the State is a partner, and taxation is only what is due to the partner. This idea, which Lord Snowden developed, was originally suggested by Dr. Marshall in

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[1] A. W. Mellon, *Taxation, the People's Business*, 1920, *passim*. "It is no part of the system of Taxation to correct the vicissitudes of fortune" said Newmarch. Mr. Mellon contends that "Taxation is not a means of confiscating wealth but of raising necessary resources of Government."

[2] *If Labour Rules.*

[3] L. T. Hobhouse's opinion cited above.

[4] Snowden, *Labour and National Finance*, p. 32.

1890, as the only satisfactory explanation of the character of the Indian land revenue.[1] A third explanation centres round the theory of *conjunctur*. Wealth and differential earnings are both due to a conjunction of economic circumstances for which the entire community, rather than the individual is responsible. Income, which arises in such circumstances, is therefore lawfully suitable for public appropriation. A fourth justification of fiscal measures, which seek to reduce economic inequalities, is furnished by the theory of the 'economic surplus'. Dr. Marshall's famous doctrine that the rent of land, conceived as a surplus, is not a thing by itself but part of a wide genus, has been applied to every form of differential gain. The claim of the State for the appropriation of such surplus is based on two grounds: (1) being a surplus, its appropriation by the State will not diminish productivity; (2) and as such, it belongs to society rather than to the individual. The doctrine has been used even in support of progressive taxation.[2]

Move against Inequality.

But, is the reduction of inequality a compelling aim of the modern State? The trend of recent social thought furnishes an answer. We seem now to be in a temper to reconstruct economic society as we were once in a mood to reconstruct political society.[3] In the reconstructed society of the future inequality is to vanish. The movement against inequality derives support from a mixture of emotion and calculation. Mankind no longer passively accepts poverty as its lot. "Inequality is on the defensive."[4] Materialism has

[1] Marshall, *Principles of Economics,* 1st edn., 1890, pp. 678-682.

[2] There are, of course, other grounds for progressive taxation.

[3] Woodrow Wilson, *The New Freedom,* 1913, p. 26.

[4] F. W. Taussig, *Principles of Economics,* II, p. 256.

replaced in many minds the old other-worldly considerations by purely economic motives. Hopes of compensation after death no longer keep the poor in contentment. As forms of government get popularised, the contrast between political equality and economic inequality must become vivid. The poverty-stricken owners of suffrage must then become conscious of a divided personality. They will possess "political sovereignty" but be under economic servitude.[1] Political leverage will accordingly be applied for economic levelling, and it will be found readily in schemes of taxation. Few now believe that if Society is left to itself, inequality will disappear of its own accord.

In the application of means to ends, modern fiscal reformers are ready to give up or modify the old 'doctrine of equality,' both as a taxing and a spending principle. The policy which provides special amenities to the poor and the helpless is based on the view that it is to the public interest that they should receive unequal (*i.e.*, preferential) treatment. It may seem therefore illogical that in taxation a rigid equality should be (even if it could be enforced) the guiding principle of the distribution of tax burdens.[2] The incompatibility of liberty and equality has long been recognised.[3] Give freedom, and men who differ in ability, in application and in thrift will necessarily attain unequal economic positions. It is sometimes argued[4] that the attempt of the State "to rectify inequalities of fortune by taxation, beyond that part of the inequality which is not a proper reflection of the inequality of ability, application or thrift," is illogical and unjust. It is also

[1] Somewhat as in the last days of the Roman republic.
[2] M. E. Robinson, *Public Finance,* 1922, p. 33.
[3] Sir James F. Stephen, *Liberty, Equality and Fraternity,* 1873.
[4] Sir J. Stamp, *Principles of Taxation,* p. 175,

urged that the view that the aim of progressive taxation is to rectify inequalities in distribution, is an exaggeration. This line of criticism misses the differential benefit, which the economic environment or *'conjunctur'*, confers on some persons and denies to others, and the fact that inequalities cannot always be traced to differences of natural aptitude or ability. The fundamental question whether inequality is a necessary condition of productive efficiency is also raised.

Its solutions.

Several means have been suggested for the reduction and final extinction of inequality. The conservation of natural resources by the State or their nationalisation, *e.g.*, land, mines, etc., is one. Another is that *true* rent, wherever it occurs, should be appropriated by the State. Even a conservative thinker like Dr. Marshall,[1] deplored the failure of the State to do so from the beginning. His suggestion was valuable in regard to the relation of the State to land in India, and to undeveloped natural resources in mines, forests and agencies for generating power. The poor should be helped to redeem themselves by their own effort by providing them inducements and facilities for the same. The taxation of inheritances, and the establishment of government monopolies of remunerative undertakings like life-insurance and of the businesses of banking, credit and transport, in which large private agencies have even now to be controlled in the public interest, are among other such plans. But, most of these schemes appear to overlook the real causes of inequality, namely, inborn differences in gifts, and the perpetuation of acquired advantages, through environment, and through the rights of property and inheritance.[2] The

[1] *Principles of Economics*, pp. 802-3.

[2] Taussig, *Principles of Economics*, II, 246; H. Dalton, *Inequality of Incomes*, p. 244.

comparatively lower birth-rate of the affluent classes also enables inequality to stabilise itself.[1] There has been no time when there was no private capital or inequality. Inequality has been and is still found in pre-capitalist societies, and it does not appear to have been planned away even in Soviet Russia.

Ulterior aims of Taxation.

The use of taxation for ulterior purposes includes its application penally and restrictively, as well as in controlling the direction and volume of trade. The External Capital Committee (1925) considered and rejected[2] the suggestion that penal taxation should be imposed on foreign companies to encourage indigenous industries. British Labour has also in its economic creed a condemnation of penal taxation. Taxation may result in a discrimination, which will replace external by internal capital. The exemption which the Indian Income-tax Act of 1922 now gives to foreign investments, when the income therefrom is not brought into India within three years, is acting as a positive encouragement for investments outside India. The capitalistic exploitation of wasting assets, like oil, mining products and minerals generally, might justify the use of taxation to diminish such exploitation by foreign capital.

Customs duties are freely advocated for the protection of local industries, for ensuring home supplies of essential articles required in War, for cementing imperial unity and for helping nascent industry. Such policies are, as Dr. Marshall pointed out,[3] easy to embark

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[1] Irving Fisher, *Principles of Economics*, p. 483.

[2] See p. 25 of its *Report*. The new Government of India Act prohibits such discrimination. *Vide* Sections 112 and 113.

[3] In *After War Problems*, ed. W. H. Dawson, 1917, p. 330.

on, but difficult to withdraw from. It is always possible to make out that the advantage of interested groups is a national benefit. Sir Josiah Stamp has proposed that instead of restraining by customs duties the exportation of essential articles needed for national defence, their production should become State monopolies.[1]

The application of taxation to regulate consumption is usually justified by a reference to the success of the methods adopted in drink control. In Great Britain, the excise on drink or the license tax is the historical descendant of a long defunct State monopoly. The control of drink for moral rather than for fiscal purposes was known to ancient Indian financiers. It is developed by Kautilya.[2] The present methods of licensing are defective in an important respect. They fail to discriminate between the tenth glass of a drunkard and the occasional glass of an abstemious person. In India, religious and social considerations make for temperance among large sections of the population, and the craving for drink is found mostly in the poorer classes. The principle of the maximum revenue with the minimum of consumption cannot be relied upon to reduce to any appreciable extent the amount of the drink consumed. To the affluent, a high price may itself prove an attraction, and to the poor, whose craving for drink springs from physical and mental infirmity, the enhanced cost of liquor would only intensify distress. An absolute

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[1] *e.g.*, Wolfram supplies.

[2] See Kautilya's *Arthasastra*, Mysore, First edn., p. 55, the liquor shops have to be given a special location; pp. 119-121 (II, 25), the manufacture and sale of fermented liquor is to be centralised, in the country, capital and camps. The places of sale are to be distant from one another. *Liquor is to be sold* only in *small quantities, and ordinarily it should be drunk in the premises*. The manufacture and sale are to be only under licence. The sale of drinks in camps is prohibited. See also *Sukraniti*, Bk. IV, Ch. 4, cc. 89-90, which prohibits the sale of drinks in day time, and wants the toddy shops to be placed outside village bounds.

State monopoly of manufacture and vending, and sales restricted to small quantities at cost price to those who drink, in conditions attaching stigma, as in ancient India, may perhaps prove more effective. As a matter of fact, our present policy has only made bigger inroads into the narrow means of the Indian poor, whose habits and half-starved condition provide the chief incitements to drink.

On the question of the distribution of the burden of taxation there has been a change in outlook. In 1897, Dr. Marshall[1] pointed out, with approval, that the old principle that all persons should contribute to the system of onerous taxes in proportion to their net incomes was being replaced by the new that the poorer classes should contribute a smaller percentage of the revenues than the middle classes, and these again a smaller share than the richer classes. Mr. Lloyd George's declaration in 1911—"All should give as in a Church, but according to their means,—they all have an interest in the State"—would appear to modify this precept. The traditional Liberal view is enunciated by Mr. F. W. Hirst, and justified by a political reason: "All electors, however poor, should contribute something to public revenue, and that something should rise with public expenditure. Otherwise, the people as a whole will not have interest in an honest, capable and economic administration". This opinion is criticised by economists with a socialist bias, like Dr. Dalton. They maintain that a sense of political responsibility can exist independently of the consciousness of paying taxes, and that where it is absent, owing to defective education, taxation alone will not create it. Indirect taxation escapes detection and cannot obviously stimulate this sense of responsibility. A dislike for particular forms of taxation may be developed by a press campaign. With reliance on

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[1] *Official Papers*, p. 337.

customs and the salt tax as financial reserves of the Government, and the maintenance of a land revenue system which does not allow for any exemption, the Indian fiscal system appears to afford a contrast to the above views. The heavier taxation of the rich on the Socialist grounds that the possession of a large untaxed income is a social disadvantage and a political menace, and that excessive wealth leads to luxury and vice, seems to ignore the difficulty of drawing the line between competence and affluence, at which alone the temptation to extravagance and evil-living is assumed to begin. Dr. Dalton[1] would exempt all persons of small means from taxation, in spite of their liability under a doctrine of equal or proportional sacrifice, and he would do so on the sole ground of its being uneconomical to have a large number of poor assessees. This was one of the grounds for raising the exemption limit of the Indian income-tax from Rs. 500 to Rs. 1,000 in 1886 and from Rs. 1,000 to Rs. 2,000 in 1919.[2]

New Attitude towards Direct and Indirect Taxation.

The contrast between old and modern views is to be seen in the altered attitude towards direct and indirect taxation. Direct taxation was once very unpopular in England, and the income-tax, which was vehemently opposed at the beginning, became a permanent feature of the British Revenue System only in 1890. In a memorable and picturesque simile, Gladstone had justified the use of both, in his budget speech in 1861.[3] In India the income-tax was bitterly attacked when it was introduced

[1] *Public Finance*, p. 171.

[2] Since 1931 the limit has once again been lowered to Rs. 1,000.

[3] "I never can think of direct and indirect taxation except as I should think of two attractive sisters, who have been introduced into the gay world of London, each with an ample fortune, both having the same parentage—for the parents of both, I believe, to be Necessity and Invention—differing only as sisters may differ. . . . I cannot conceive any reason why there should be any unfriendly rivalry between the admirers

by James Wilson in 1860.[1] Prejudice in India against the income-tax persisted till Sir Auckland Colvin passed the Act of 1886 and made it permanent four years before it became so in England, and twenty-eight years before it was adopted by the United States of America. The constitutional reason for favouring direct taxation has been upheld by Mr. Harold Cox, and the social argument by Professor Seligman. In India, direct taxation has a great future in view of its amenability to the principle of progression.

As regards indirect taxes, there is a curious divergence between the official attitude in India and Great Britain. Indian Finance Ministers have looked upon them as their most important reserves. For example, Sir Malcolm Hailey said in 1922: "When additional revenues are required, the first head to which one's thought turns is customs". Ten years later, Sir George Schuster improved on this statement: "If in times of emergency we need to raise extra revenue, our *most sure and reliable* course is to impose slight increases on the taxes which fall on the masses of the population". The "odious" revenue from salt is justified on this ground. The prejudice against indirect taxation in Great Britain, on the other hand, has been both strong and persistent. In 1888, Goschen criticised taxes on consumable commodities as 'a halting and inelastic revenue',[2] and stigma-

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of the two damsels; and I frankly own, whether it be due to a lax sense of moral obligation or not, that as a Chancellor of the Exchequer, if not as a Member of this House, I have always thought it not only allowable, but even an act of duty to pay my address to them both. I am, therefore, as between direct and indirect taxation perfectly impartial." (Sydney Buxton, *Mr. Gladstone as Chancellor of the Exchequer*, 1901, p. 143.)

[1] See Pramathanath Banerjee, *History of Indian Taxation,* 1930, pp. 81-92. Sir Charles Trevelyan, whose premature publication of the objections to it led to his recall from the Governorship of Madras, stated publicly when later he was Finance Member, in 1863: "It has been my earnest desire ever since the Income-tax was established that I might see the day when it would be fairly given up."

[2] Mallett, *British Budgets, First Series,* p. 12.

tised the tea-duty as a poll-tax.[1] In 1913, Lord Snowden denounced food taxes. "Indirect taxes," he maintained, "violated every canon of taxation. They tax a man not in proportion to his ability to pay, nor according to the benefit he receives, but according to his personal tastes". He argued with some ingenuity that, even without paying indirect taxes, the poor would be contributing to the maintenance of the nation, "because they work and labour and create the wealth of the nation", and because the taxation of the rich is really a payment by the poor, who have been exploited by the affluent.[2] In the British Labour Party's programme, indirect taxation is anathema. It is condemned as uncertain in incidence, as easily evaded, and as uneconomical, owing to its disproportionate cost of collection in relation to the yield.[3] The divergence in view may be explained by the differences in the historical, constitutional and economic conditions of India and Great Britain.

The attitude of Labour towards a tax on the economic rent of land is different. Rent is viewed as a 'social' product, and its public appropriation is not therefore unjust. "There is an unanswerable case in support of the heavy taxation of the economic rent of land".

The influence of such views on modern Indian Finance is shown in the persistence of the attacks on the customs tariff and the salt monopoly, as well as on the drink revenue, and the proposal, which has had powerful official support, including that of the Indian Taxation Enquiry Committee, for bringing the income from land within the ambit of the income-tax.

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[1] Mallett, *British Budgets*, First Series, p. 31.

[2] Mallett, *British Budgets*, Second Series, p. 11.

[3] Philip Snowden, *Labour and National Finance*, pp. 93-94.

The Amortization Theory.

The theory of the amortisation or capitalisation of taxes, which J. S. Mill expounded and Prof. Seligman has upheld,[1] may appear to support the old saying—"an old tax is no tax". It is supposed that people bear the ills they are accustomed to better than new troubles, and that they do not discriminate between their relative intensity. Mill's argument that a land tax is not a payment exacted from the *present* landlords, will, if it is correct, have an important bearing on the treatment of the Indian land revenue.[2] The principle will, however, properly apply only to differential incomes. If the land tax is repealed, the persons who will benefit by the repeal and by the increased sale value will be the present owners. The incidence of the land-tax must therefore be deemed to be on them.[3]

Progressive Taxation.

A cardinal contribution of modern fiscal theory is the principle of progression or graduation in Taxation.[4] J. S. Mill expressed his disapproval of graduated taxation, in his great treatise published 1848[5] and continued in the opinion all his life. His condemnation became more forcible in 1861, when he made this assertion: "A graduated income-tax is an unjust mode of taxation, and

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[1] E. R. A. Seligman, *Shifting and Incidence of Taxation*, 1892.

[2] See *Imperial Gazetteer*, Vol. IV (1907), p. 234.

[3] H. Dalton, *Public Finance*, p. 70.

[4] For the hostility to it, see E. R. A. Seligman, *Progressive Taxation*, 2nd edn., 1908, pp. 141-2. As late as 1893, Stourm denounced it as an instrument of general spoliation. The veering of opinion in its favour in the U. S. A. is illustrated in General F. A. Walker's *Political Economy*, 1883, p. 479, in which progressive taxation was defended on the ground of its compensating the unaffluent for economic inequalities due to the State's acts of commission and omission.

[5] *Political Economy*, edn. W. J. Ashley, pp. 806-9.

is in fact a graduated robbery". The same year, Newmarch also condemned graduation, characterising it as "confiscation, punishing prudence and virtue, taxing a man for being good to himself and for doing good to others". Such exuberance of condemnatory language will now appear surprising. The exposure of the fallacy underlying these views is due to the diffusion of Socialist views and to the development of two branches of economic theory, namely the 'marginal theory' and the theory of 'diminishing utility'. The latter tries to show the diminishing utility of money to its possessor with every step in its further accumulation.[1] Progression has been justified by Mr. Hobson[2] on the application of rental or surplus idea to a person's income. Dr. Marshall, who has done more than any one else to popularise the basal economic theories behind the idea of progression, found in it[3] an engine for social improvement. The taxation of 'fortuitous accretions of wealth' or of excess profits, and the discrimination between 'earned' and 'unearned' incomes, which are now urged as essential features of modern tax systems are deductions from these theories.[4] The taxation of excess profits due to the War and of War-made wealth, rests on this principle. Cash prizes won in lotteries are liable to taxation in

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[1] This has been challenged in recent writings: Cf. L. Robbins, *Nature and Significance of Economic Science,* 1932, p. 125; and Barbara Wootton, *Plan or No Plan,* 1934, pp. 112-113; but, the criticisms seem inconclusive, and the strong language of Professor Robbins appears especially to lack justification.

[2] *Taxation in the New State,* 1919, p. 65; and his later *Wealth and Life,* 1929, pp. 442-3.

[3] W. H. Dawson (ed.), *After-War Problems,* 1917, p. 328.

[4] The exemption of fortuitous income from income-tax in India under the Act of 1922 is open to criticism under this principle, and as being an illogical imitation of the British income-tax practice, which confounds capital with income which is occasional.

Australia.[1] They are not taxes in British India, where 'casual' gains are exempted.[2]

Taxation of Unearned Income.

The popularity of a fiscal discrimination against unearned income is probably due, as pointed out by Professor Taussig,[3] to its containing the dynamic idea of the progressive reduction of inequality. Applied to inheritances, the principle fails to distinguish between the thrifty and spend thrift heir.[4] Among economists of a conservative bent of mind, like Prof. Taussig,[5] there is a disposition to regard progressive taxation as a less effective way of reducing inequality than other ways, such as the equalisation of opportunity through widespread facilities for national education, the control of monopoly industries, and the removal of conditions which make illegitimate profits possible. "Progressive taxation, which deals with income or property solely according to size, and not according to social desert, is less discriminating and less effective in reaching the ultimate goal than the various ways of spreading material welfare". The defect of this view is that it does not recognize that the plans which it outlines can be brought into effect only by additional resources, for raising

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[1] Sir J. Stamp, *Principles of Taxation,* p. 67.

[2] V. S. Sundaram, *Law of Income Tax in India,* 1928, p. 391. Bookmaker's profits are taxable. They may be uncertain but are not 'casual'.

[3] *Principles of Economics,* Vol. II, p. 517.

[4] There is some difficulty in drawing the line clearly between 'unearned' and 'earned income' as the line will be shifted according to the 'social outlook of the person who makes the attempt. It is sometimes asked for example, whether the income derived from 'earned' savings, which are invested, is to be regarded as 'unearned'. Most modern economists will answer in the affirmative.

[5] *Principles of Economics,* 2nd edn., 1928, II, p. 492, and Sir J. Stamp, *op. cit.,* p. 176.

which progressive taxation furnishes the most useful and convenient instrument.[1]

The Super-Tax.

The Super-tax is also, and wrongly, justified by reference to the equity of taxing the surplus income which accrues through the community. Its underlying principles are different. There is first of all the idea of progression based on the law of diminishing utility. The utility of an increasing money income is held to diminish steeply with its growth, after a point is reached. Sir Josiah Stamp has suggested another explanation based on a conception of the relation between the community and the individual: "Is any person worth to his society as much as his income? If he is not, let that part of his income which represents the excess over his social utility be transferred to the community". An income of £5,000 or Rs. 30,000 per year—the super-tax base limits in Great Britain and India respectively—will be presumed, under this hypothesis, to be the limit of the value of the owners of the income to their respective communities. But such estimates are arbitrary, and they appear to ignore the function of great incomes, as of the desire for affluence, as stimuli to economic activity.

The Concept of Taxable Capacity.

Modern financiers follow the classical tradition which stressed 'taxable capacity'—what a person could afford to pay—as the criterion of fairness and efficiency in finance. The expression 'taxable capacity' is used in

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[1] On the other hand, it will be well to note that the application of progressive rates to business incomes is unfair, as it discriminates against mere size. But, this feature is liable to be overlooked in a democracy, where it is easy to place additional burdens on groups which are economically strong but politically weak. See *Encyclopaedia of Social Sciences,* XIV, 1934, p. 540.

two senses. As regards the taxpayer, it implies the limit beyond which taxation cannot be carried without reducing his willingness to work or impairing his productivity. As regards the tax itself, it indicates the point from which the aggregate revenue from the tax begins to decline, *i.e.*, the danger limit to further taxation. The first sense lays stress on equity, and the second on advantage to the State. Ability to pay is subject to several conditions. It varies first with the application of the revenue. As Dr. Hugh Dalton[1] has shown by a minute analysis, it is difficult to say what one can really afford to pay as a tax, unless the way in which the tax is to be expended is also considered. Capacity varies with the psychology of the taxpayer. The enthusiasm created by a national emergency like a popular war, will reveal limits to capacity, which are invisible in ordinary times. The potential reserves of a nation are difficult to get at without the assent of the persons who possess them. In this lies a justification for the financial education of the people and their representatives. The Legislature's consent to taxing programmes depends on the ability of the Finance Minister to convince it of the necessity and the wisdom of his plans. Persuasion has to be reinforced by an assurance that the Legislature will be allowed to pursue the expenditure of every rupee of the sanctioned estimates. The success of a tax, judged by the collections and by the elimination of friction in collection, will depend very largely upon the willingness of the persons who are taxed to contribute their respective quota. In political organisations in which the relations of the Government *vis a vis* the people are not friendly, the appeal to the popular mind is even more necessary than in self-governing communities. The education of the

[1] *Public Finance,* p. 169.

taxpayer in India must therefore form an integral part of both government and non-official propaganda.

Obviously, the *methods* of collection and the rate of a tax must affect taxable capacity, in either of its meanings. Adam Smith's Canons of Economy, Certainty and Convenience spring from this idea. The prominence given in modern finance to administrative convenience is also due to it. Our society is very complex. The amounts involved in modern taxation are colossal. Accordingly, a fiscal system must now-a-days justify itself by its proved efficiency. Revenue administration must aim at a high degree of technical perfection. The avoidance of unintended discrimination, as an incidental consequence of taxation, also comes within this principle. For, just as 'taxes tend to stick where they fall, so differential favours tend to stay where they are given'. Friction diminishes the amount collected, and its effect is cumulative.[1] In democracies, and particularly in the sphere of local self-government, if a high standard of civic responsibility is not widely developed, the assessment and collection of taxes must steadily deteriorate.

That taxable capacity will vary directly with the manner of the distribution of wealth in the community, and progressively with the rate of increase of wealth, growing at a greater rate with the growth and shrinking more rapidly with diminution of wealth, is equally true, though not quite obvious. The modern arguments in defence of meeting 'development expenditure' from taxes, and for the reduction of economic inequality by fiscal and other means, are grounded on this principle. If the sums raised by taxation are expended on wise development within the country, or even if they are made

[1] Stamp, *Principles of Taxation*, p. 30, and the *Economic Journal*, 1911, p. 312.

to add merely to the earnings of 'nationals', it must increase the nation's capacity to bear additional burdens. The criticism of India's 'Home charges', her Defence expenditures, the purchase of her stores in Great Britain, and the costly foreign element in her public services, are all condemned by nationalist opinion in India on the ground that they contravene such principles.

Per contra, it is contended that, in the craze for tax reductions, on the plea that the tax-burdens exceed the capacity of a nation, it is possible to over-shoot the mark. Reduced resources must imply reduced 'development' expenditure, reduced economic strength, and reduction of taxable capacity. This argument would favour increases of taxation in the interests of social uplift, and consequential improvement of taxable capacity. It is on such grounds that Socialist leaders in Parliament maintained in the budget debate of 1925 that high direct taxation cannot affect industry adversely, and Lord Snowden[1] made the paradoxical remark that 'no trade is ever stimulated by low taxation'. The old view that by light taxation savings will be left 'to fructify in the pockets of the taxpayer' carries the implication that individual uses of savings or income are wiser than collective uses directed by the State—a point challenged by Collectivist opinion. Unless the revenues garnered by the State go out of the country, without a proper economic return, it cannot be validly maintained that the purchasing power in the hands of the community will be diminished by high taxation.

The conception of 'taxable capacity' cannot be dismissed, as it has been by Socialists, as "worthless and

[1] For Lord Snowden's argument, see Mallet and George, *British Budgets,* Third Series, pp. 138-143 (Summary of the budget debate of 1925).

misleading".[1] There have been different ways of estimating taxable capacity. Sir Josiah Stamp would measure it by the amount of saving. Dr. Dalton objects on the ground that if this be the criterion, no community will ever exceed its taxable capacity. It is sometimes said that absolute taxable capacity is a myth, though nothing further is implied in the declaration than that the limit of taxable capacity is neither an absolute nor a fixed line or amount, but one which will vary with circumstances.

Modern Ideals of Taxation—The Civic Minimum.

Recent ideals of taxation may be illustrated by some of the claims made by the British Labour Party in 1909, and by Lord Snowden's enunciation of them in 1929 in his *"Labour and the New World"*. The earlier Labour view was that taxation should be in proportion to ability, protection and benefit conferred on the individual by the State. This view has now been qualified so as to imply that private property is a public trust and must be surrendered at the demand of the State,[2] "that the State is a silent but helpful partner in the production of wealth",[3] and that the community has the right, in the words of President Roosevelt, to take as much as it needs of the property of the persons who are not able to use it. The test of the ability to pay is replaced by the necessities of the State. The claims that the unit for taxation should be the family and not the individual, that taxation should not encroach on the individual's primary needs, and that the fund available for taxing is the surplus of income over necessary expenditure are all affiliated to the principle of taxable

[1] H. Dalton, *Public Finance,* p. 169.
[2] Stamp, *Principles of Taxation,* p. 134.
[3] *Ibid.,* p. 149.

capacity. Progressivists, like Lord Passfield, advocate the recognition of a 'national' or 'civic' minimum standard of life for all persons, which will be correlated to efficient life and not to mere subsistence, and they plead for its total exemption from taxation, and for liberal national expenditure to improve the conditions of the indigent. Unless the earning capacity of those who now do not have this 'civic minimum', and must hereafter get it, is increased by the improvement, it might result in a reduction of the resources of the State and thereby restrict the scope for beneficial public expenditure on development. The ideal of the *total* exemption of even the indigent from taxation is manifestly difficult of attainment, unless all indirect taxation is withdrawn.

Change in Fiscal Viewpoint—Duties and Rights.

Fiscal science is experiencing an adjustment of viewpoint in response to the altered conceptions of Society and the State.[1] The idea that duties rather than rights and privileges should be stressed in Politics, and that an enduring freedom and the conditions of healthy life and growth are most satisfactorily attained by a widespread popular conviction that a balance of obligations is necessary for the perfect State, is replacing both the old individualism and the old constitutionalism. There is now also a tendency to view the State, in the spirit of Burke, not as a temporary union for limited or specific purposes but as an association for all time and for the good life.[2] In the domain of Public Finance these conceptions involve the substitution of the social for the individual standpoint, and of

[1] Vide *supra*, p. 50.

[2] See Lord Eustace Percy, *Government in Transition*, 1934, *passim*; Burke, *Reflections on the French Revolution* (*Collected Works*, 1906, Vol. II, p. 368); and my Calcutta University Lectures on *Indian Cameralism*, *Lect. III* (*to be published shortly*).

the inaudible calls of the future for the clamant demands of the present. These are, as I have pointed out elsewhere, in accord with the old *Hindu* conceptions of Finance. Their revival in India may enable our future ministers to frame their fiscal schemes with greater confidence and less risk of friction than at present. The changes in outlook may be thus summed up: "Taxation is become more subjective, specific, personal and presumptive".[1]

The Budget.

The formal statement of expenditure and the income necessary to meet it, in a public document, is the Budget. The importance of finance to society and the pressure of public opinion make the Budget the pivot of modern administration. It is in the changed conceptions of the Budget that we may therefore hope to find the germinal fiscal ideas of the future. Post-War financial practice, and even the movements during the decade before the War, have changed in many respects the traditional outlook on, and the attitude to, the Budget. That the Budget should be annual, that it should aim at a surplus, that a deficit is a misfortune, and that a surplus which exceeds a nominal figure is improper, are old views which are now questioned or given up. The growing demands for social services have overcome the old fears of heavy budgets. In Great Britain, the practice of budgetting for a definite non-fiscal purpose, was begun in 1909 by Mr. Lloyd George. In 1910, when commenting on the Budget, Mr. Snowden expressed the wish to see the day when the British Chancellor of the Exchequer would present budgets involving expenditures of £300 to 400 millions.[2]

[1] Stamp, *Principles of Taxation,* p. 24.

[2] His wish was realised sooner than he perhaps anticipated, when he gave expression to it.

The Budget and the Legislature.

The arrangements for the preparation, presentation and discussion of the Budget in countries enjoying some form of responsible Government, now involve an interval of about eighteen to twenty-four months between the preparation of the estimates and plans and their execution. With the unexpected changes that may be brought about now-a-days by internal as well as international causes, forecasts made so far ahead are liable to prove wide of the mark, even when the estimates are made by experts.[1] A defect in modern organisation and practice is that the examination of the Budget in the Legislature is never sufficiently thorough or effective. In Great Britain, the Budget is discussed *after* the financial year to which it relates has commenced. In India it is taken up just *before* the beginning of the year to which it relates. A proper and adequate popular scrutiny of the Budget is not possible in our country owing to the lack of experts on the popular side, the absence of definite fiscal policies in our party programmes and bad party organization, which allows the time allotted for the discussion of the Budget to be frittered away in rambling discussions of unimportant details and frequently of questions of constitutional politics. The remedy for the evils must be sought in improved party organisation and in the fiscal education of the politician. With progress in those directions, we can expect increased care in the preparation of the Budget and increased efficiency in its legislative scrutiny.

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[1] The expenditure estimates presented by Sir Robert Horne in 1922 were extraordinarily incorrect. See the remarks in Mallet and George, *British Budgets*, 3rd Series, 1933, p. 56. It has been stated by Mr. K. T. Shah that the margin of error in Indian budget figures has occasionally amounted to 25 per cent. of the total. The estimates of 1931-32 were wrong to the extent of about 20 crores. *Cf.* Shah, *Review of Indian Finance*, 1927-34, p. 5.

Budgetary Period.

As early as 1907, H. H. Asquith pleaded for continuity of policy, and for enabling the Chancellor of the Exchequer to budget not for one year but for a term of years. "It is a mistake", he said, "to treat the annual Budget as if it were a thing by itself, and not as it is, or as it certainly ought to be, a necessary link in a connected and coherent policy. The country has reached a stage in which, whether we look merely at its fiscal or its social exigencies, we cannot afford to drift along the stream, and treat each year's finance as if it were self-contained". This view, questioning the sanctity of the budget period of twelve calendar months, has received reinforcement since then.[1] In Great Britain, both the revenue and expenditure returns are usually slow in coming in for eleven months out of the twelve, and they are made up in a rush during the last weeks of the financial year. This is so in India as regards expenditure. Such a system diminishes the sense of responsibility and economy in the spending departments. Public expenditure must be suitably spread over the year. The delay in the accrual of the revenue may be unavoidable, and it can only increase the interest charges on the floating debt. There is a good case for adopting a longer budget period than a year. The objects in view may be attained by a convention that the expenditure on schemes of education, public works, and defence reorganization, which require a long period for execution, shall be provided for in recurring budgets. The objection to leng-

[1] The League of Nations' plans for reorganisation in Austria and Hungary instituted monthly budgets, and monthly publications. Poland made the accounting period a month, on the advice of Sir Hilton Young. These instances merely show that *annual* budgets are not now the rule, but innovations are forced by the special difficulties of the States, which make long-term budgetting impossible.

See H. Dalton, *Unbalanced Budgets*, pp. 14, 325, 362 and 378.

thening the budgetary period is that it affords a temptation to those in power to indulge in vote-catching finance. Sir Bernard Mallet[1] has enumerated other reasons for not varying the traditional budgetary period: it may prove conducive to economy; and it is not safe to arm a Finance Minister with funds for purposes for which the endorsement of the Legislature may not always have been previously obtained. These objections appear weak. Party Government which aims at stable political equilibrium can secure agreements between the great political parties on fundamental questions. Even now, there is nothing to prevent the party in power from forcing the hands of its successors, by embarking on a War or by inaugurating policies with a grant limited to a year, which the successors cannot disown or revise in the face of the clamour of vested interests and the unrest which such action will rouse.

Budgets and Planning Schemes.

Modern planning, as well as the tendency to entrust to public management not only the Public Utility and Transport services, but even such businesses as Banking and Insurance, and the clamour for Public Works on a large scale to be financed out of revenues or loans, all tend to create a demand, in the interests of both continuity and efficiency, for financial provision on a statutory basis for more than one or two years ahead. The Government of India made some years ago a grant of Rs. 150 crores for railway development to be expended during a period of *five* years. The big schemes of economic reconstruction, which are now in the air, will, if adopted even partially, necessitate similar block grants.[2]

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[1] *British Budgets,* First Series, p. 281.

[2] The Contract Budget System tried for the Defence estimates of

The absence of "responsibility" in the Central Government in India is an impediment to long-time Budget planning. It sharpens the non-official criticism of Government measures, and intensifies the distrust of the Government. Non-official opinion holds it to be unwise to allow an "irresponsible" executive to commit India, on the threshold of Responsible Government, to big schemes of expenditure, which might eventually fail. The British Conservative Party's attempts to secure the intractable and rigid items of public expenditure, like the Military and Home charges, the interest on the Public Debt and the emoluments of the Security services, against future legislative interference, by including them among the statutory financial "Safeguards", may, if they succeed, render it necessary to divide the Central Government's Budget into a permanent and a fluctuating half.

The Expansionist View.

Long term budgets are the corollaries of economic planning and of schemes of recovery, which are now in vogue. The Soviet Five Year Plan will probably get a second renewal. The National Recovery Measures in the United States of America have now passed the time-limit originally fixed, and seem likely to continue indefinitely. The *Expansionist* views of economists like Sir Arthur Salter, Mr. J. M. Keynes and of the Macmillan Committee, appear to find support in recent German practice. According to them, escape from disequilibrium and its causes, has to be sought, not in economies which involve a contraction of production, but in a carefully planned expansion of productive activities,

India in 1929 was declared to be in the interests of a special economy campaign to eliminate all unnecessary expenditure, which the Commander-in-Chief has agreed to inaugurate. (*See* para. 3, Ch. VIII, of the 'officially contributed' articles on the Indian Army Budget which appeared in the Indian newspapers in March and April, 1934.)

which will employ all idle resources, increase revenue and simultaneously diminish the national bill for the relief of poverty and unemployment. The State is therefore urged to stimulate development either by supporting public works on a vast scale, under its own supervision, or by guaranteeing minimum rates of profits to private undertakers.

The "expansionist" doctrine can be carried to a point which transcends economic possibilities. In any case, it appears to be more suitable to a self-governing and opulent country like the U. S. A., with resources which are still undeveloped, than to a country like India. But, it will be possible for India, without going to the lengths of uncontrolled expansion, to adopt a long-term budgetary practice, which will be free from the risk to which Mr. Keynes has drawn attention,[1] *viz.*, that the measures which balance the budget one year may unbalance it the next year.

Unbalanced Budgets.

Retrenchment and increased taxation are not now much in favour as the best methods of balancing the budget. They are considered as likely to lead to low prices, diminished purchasing power and reduced production, which will cause budgetary disequilibrium. The remedy of "Re-flation" will increase production, raise prices, relieve depression and balance the budget. An *unbalanced budget* was once dreaded as a confession of national bankruptcy. It is now being elevated to the position of a fiscal ideal! Obviously, continuous deficits are not things to be proud of. The want of budgetary equilibrium, in a subordinate Government as in an Indian province, may not necessarily be a cause for

[1] *Means to Prosperity*, 1933, p. 13.

concern, for it may be due to extraneous causes, over which the unit itself has no control. Even in independent governments, an unbalanced budget need not always carry an implication of insolvency. A budget only gives estimates of income and expenditure in terms of money for a short period; it cannot disclose gains or losses, which will be apparent only over long periods and which elude a monetary appraisal. In the rectification of the economic backwardness of a people as a necessary preliminary to its progress, heavy expenses may have to be incurred, which may lead to recurring deficits. But, if the backwardness is perceptibly diminishing, and the economic strength of the community is clearly growing, such disequilibrium should not cause anxiety. Welfare finance often shows this feature, even during a series of years. All the same, it will be unwise to ignore the danger-signal of recurrent deficits. The circumstance that the benefits, which are expected to accrue from large scale expenditure which tilts the budgetary stability, are incapable of precise measurement should make it necessary to curb the optimism usually generated by big plans.

Fiscal Effects of Price Changes.

In this context, it will be relevant to consider the fiscal effects of price changes, howsoever brought about.[1] Socialists have seen in falling prices powerful stimuli to industry and saving. This opinion resembles the old view that a lowering of the rate of interest will increase the volume of national savings, for which statistical proof is still lacking. Ordinarily, financiers no less than businessmen dread a slump. A general reduction in prices must obviously diminish public revenues. Customs duties, which are ordinarily rated on prices, will

[1] See *Encyclopaedia of the Social Sciences,* VIII (1933), pp. 29-30.

bring in less than before. If the low prices are due to a general depression, there will be shrinkage in the pile of taxable goods. A contraction in the volume and the value of business transactions will follow, and they in turn will bring about a reduction in the income from stamps, registration, and fees of various kinds. The revenue from the Income-tax will automatically diminish. If the Income-tax rate is progressive, as it now is in most countries, the fall in revenue will be more than proportionate to the shrinkage in private incomes. Tax payments will be either delayed or defaulted. The Public Utility services, managed by the Government, will bring in less revenue. But, the fall in prices will not lower interest charges on the Public Debt, expenditure on pensions, fixed salaries and similar items.

Modern Price Control.

There has therefore been a great inducement to modern Governments to attempt price control, both directly and indirectly. The 'Corporate' State is going back to the old belief that a slump results solely from the misfit of production and consumption. It accordingly strives to regulate both, by fixing prices by fiat, and by imposing standards of consumption. The downward movement in prices is sought to be prevented by restriction of supplies, enforced by the State, by reducing wastes, due to intermediaries in marketing, and by the provisions of State agencies to help in the barter of produce. The trend of opinion in Italy is illustrated by a contribution by Senator G. Agnelli, the President of the Fiat Motor Company, to a recent number (Feb. 1934) of the *Reforma Sociale*. He argues that attempts to stimulate exports by lowering wages or devaluing the *lira* are undesirable. The State should undertake through its Corporative organisations the monopoly of

foreign trade. Exports should be sold at world prices, and imports at prices just enough to enable exporters to earn a subsidy, equal to the difference between export prices and costs of production.[1] Italy has also inaugurated vast programmes of public works (*Bonafica*) which are designed to develop the productive capacities of the country, and thereby increase the purchasing power of the people. Illustrations of the practices may be found in the recent history of the World—in countries ranging from Russia to the United States of America, and from Italy to Sweden.

Problems of Nationalisation.

We have now come face to face with the problem of widespread and progressive Nationalisation.[2] The traditional opposition of the British Liberals to Nationalisation has weakened. In justifying his unfortunate preference for Company as against State ownership and management of the railways which he projected in India, Lord Dalhousie put in an extravagant form the old Liberal indictment of State management: "The conduct of an enterprise, which is undertaken mainly for commercial purposes and which private parties are willing to engage for, does not fall within the proper function of any government. Least of all should it be taken as any part of the business of the Government of India".[3] Curiously enough the view survives to our day in certain quarters of India. The opposed modern view, was stated (December, 1932) with equal exaggeration by Prof. Spirito: "Atomic individualism began with 19th century Liberalism. It is to-day a bankrupt

[1] This is 'controlled' foreign trade and not 'dumping'.

[2] See *Encyclopaedia of the Social Sciences*, VII, pp. 112-113.

[3] Minute, dated 20th April, 1852. But, in an earlier Minute, dated 4th July, 1850, he pleaded for adequate State control over the railways on the ground that they were *national works*: *See* Sir W. Lee Warner, *Life of Lord Dalhousie*, 1904, Vol. II, p. 200.

philosophy. We confide to the State, the Army, Justice, Education and all the most delicate tasks. Why should industry alone be abandoned to individual egoism and caprice? If it be objected that the State is a bad administrator, why not farm out the Army to private enterprise?"[1]

Effects of Post-War Experience.

The traditional arguments against Nationalisation, which are repeated even now by the British Liberals, though with steadily diminishing conviction, are sensibly weakened by the world's post-War experiences. The tendency to increase in the size and scale of business, the success of huge joint stock and co-operative undertakings, the spread of centralisation and the 'trust movement' in modern industry, the proofs of the integrity and sense of duty of public functionaries, and, above all, the experience of successful State management of production, distribution, transport and trade, during the War, have undermined the old distrust of State operations. The criticism that public enterprise, by withholding from both the worker and the supervisor, the hope of personal profit, fails to furnish the spur to initiative, which private enterprise does, is based on a low view of human character. Public service has ever carried with it a dignity, a prestige, and a sense of responsibility, higher than that of private service, in which too, healthy standards of self-respect and integrity have been steadily developing. It is conspicuously so in India. India's social and economic development, so far as it has been achieved, is largely due to the high sense of duty of the Government and of the services. The fear that Nationalisation will lead to political corruption in

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[1] Quoted by Dalton, *Unbalanced Budgets,* p. 454. Prof. Spirito's inference is not logical.

India ignores its possibility equally in the case of private monopoly. The only remedy for both is the elevation of standards of public morality, enforced by wide publicity of Government action. The alternative to-day to Nationalisation and Government monopoly is not Individualism, but Monopoly and Trusts. We cannot hereafter restrain the growth of business units, and the tendency to monopoly. The substitution of the State for the private monopoly of Trusts will therefore prove no innovation, while it will have the advantage of securing for the nation the profits of monopoly. It will also ensure that natural resources, which are necessary to all, become the property of all. The right of the State to control and regulate industry leads logically to Nationalisation.

Nationalisation and Communism.

The demand for Nationalisation is independent of the Socialist trend of the times. In Russia, for instance, State planning started only twelve years *after* the Communist Revolution. It is adopted to-day by anti-Socialist Italy, and the anti-Communist German Reich. It stands now on the secure basis of fiscal necessity. A modern financier is confronted by calls for progressive expenditure and by inelastic sources of revenue. The means open to him are three: further taxation, inflation, and borrowing. In regard to the last, the piling up of debts, especially of external debts, will only put off the inevitable crash. Inflation has proved a dangerous expedient, whose misuse has not improbably caused and intensified the present crisis. Additional taxation is possible, and it may take the form of either a further exploitation of the existing tax-resources or the imposition of fresh taxes. The springs of originality in tax-gathering are now dry. Sale taxes and Turnover

taxes have been tried. Customs have been widened and Customs duties greatly raised. Income-taxes and Super-taxes have been enhanced Inheritance taxes have been adopted, and in countries like Sweden, they have been enhanced and ear-marked for Public Works. Italy, the home of Rignano, abolished Death duties in 1923, but was obliged to revert to a modified form of them in 1930 Luxury taxes are now well-nigh universal Many novel tax-heads have been proposed or tried, but their success has not been up to expectation.[1] Holland taxed Christian names. Mr. McKenna taxed hats Dr. Marshall suggested a tax on domestic servants. The equities of the Capital Levy have been fully canvassed Rigidity of public expenditure has induced 'cuts' in the pay of public employees (except in France), and retrenchment in the social services, which has naturally irritated Socialists. Germany has tried to reduce the rate of interest on long-term loans, and lowered pensions and salaries. New Zealand, which has extended the 'cuts' to public contracts and War pensions, has only stopped short of an onslaught on her external debt.

Fiscal Aims of Nationalisation.

The exhaustion of all other means of balancing the budget, and the impossibility of building permanently on the quicksands of financial disequilibrium, have turned the attention of financiers to the appropriation by the community of all 'intermediate' profits An attraction of nationalisation of industry lies in the prospect of such gain Even a conservative thinker like Sir Josiah Stamp has advocated the assumption by the State, of the Insurance business, on more favourable

[1] See my *Problems of Our After-War Finance,* in the Indian Journal of Economics, 1920, p 13,

terms than now offered by private companies.[1] A contributor to Mr. Cole's recent symposium on Money urges the nationalisation of credit, another that of banking and investments, and a third (Mr. Colin Clark) the commandeering of the national savings of Great Britain (estimated at £300 millions) for employing a million and-a-half unemployed labourers in remunerative public works. Since 1926, all deposit banks in Italy have been controlled by the State. In Germany, the banking system is already socialised, and the Reich Commissioner of Banking and a Board of Control direct it. In the United States of America private banking is under a cloud, and the Roosevelt Plan of Recovery has provisions to curb it. Lord Snowden has long advocated the nationalisation of railways in Britain, and the creation of a State liquor monopoly.[2]

Nationalisation and Inequality.

The possibility of a conflict between Nationalisation and plans for remedying inequality should not be lost sight of. The reduction of inequality will itself lead to fiscal difficulties, the correction of which should also be planned. The implementing of the schemes will diminish indirect taxation, and it might diminish saving also, by sharpening direct taxation and the graduation of the Super-tax. Taxation will cease to be what Lord Snowden thinks it would always be, *viz.*, 'the cutting edge of Socialism'. A limit is now perceived beyond which development expenditure cannot be carried without detriment to industrial efficiency. These are the grounds on which Mrs. Barbara Wootton wants the State to rely more and more on the surpluses

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[1] Travancore has recently thrown open to the public a life assurance scheme hitherto confined to the State officials.

[2] The last was contemplated in Great Britain during the War. See Mr. Lloyd George's *War Memoirs*, Vol. I.

of socialised industries, even for its normal upkeep, because of the certainty of a shrinking of revenue from other sources.

New Fiscal Ethics.

The influence of the doleful fiscal outlook is seen in the sacrifice of consistency, and in the inroads now made upon institutions or conceptions hitherto considered sacred. Even an austere statesman like Lord Snowden was compelled to retain the British drink revenue. His plea was that, if he gave it up, it would only be a free gift to the liquor trade and increase drunkenness. In India, the Government's ideal is to secure the maximum of revenue from the minimum of liquor consumption. The policy has failed as a restraining device, since consumption has remained virtually rigid, even with steep increases in the price of drink. The increase in the price of intoxicants in India has only made a bigger inroad into the narrow means of the poor. It is possible to see in the official attitude to Prohibition fiscal loss as well as important administrative objections.

Property and Contract.

The power of fiscal exigency to modify or alter fundamental ethico-legal conceptions is illustrated by the changed attitude towards Contract. The assault on Contract is a natural sequel to the attack on Property. The two go together. The denial of the sanctity of the one has now led to the questioning of the sanctity of the other. Property exists and grows by Contract. Vested interests and rights spring from it. Freedom of Contract has limited the scope for equal opportunity to all the people. As Wagner showed long ago, contractual freedom is a myth in a regime of Property and Capital. Property, inheritance and

Contract have been behind the forces of demand and supply, and have controlled them.

The ultimate justification of freedom of Contract has to be found in its social utility. Contract has an individual as well as a social aspect, and the social aspect is now dominant. Courts and legislatures have always set aside contracts which are against 'public policy'.[1] Contracts which are manifestly injurious to the parties or to the community are voidable. English law upholds the view that a person should not be bound by an one-sided agreement. Economic considerations have influenced the development of the law of Contract between private persons, on lines supposed to be dictated by social progress.

Such principles are being logically applied to-day for determining the relations between States and their servants, and even the relations of States *inter se*. Public economy is public interest. In its name, engagements of long standing between Governments and their employees, have been modified or broken in national emergencies, and breaches of contract are being validated by special legislation. Australia and New Zealand furnish many striking illustrations. The 'revisions' of existing contracts, and the repudiation of engagements are sought to be justified by reference to political necessity or social justice. The modern State is prepared to act on the Socialist view that the "sanctity of Contract is Shylock's slogan, obstinate and absolute".[2] A rigid adherence to its contractual obligations might possibly embarrass a modern State. It is not certain that it will ruin the State. But we are now assured

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1 R. T. Ely, *Property and Contract*, 1914, II, p. 660.
2 Dalton, *Unbalanced Budgets*, p. 450.

that "the absolutists of Contract are the real parents of revolution".[1] Rights are the fruits of the law: what the State has given, the State may take away. Engagements, whether between Governments, or between a Government and private individuals, may be modified with same freedom, as those between private persons. The history of international relations, since the Treaty of Versailles, furnishes many instances of the breaches of interstatal agreements. Questioning the equity of the War debts is not very different from the Bolshevik repudiation of the public debt of the Romanoffs in 1917. Professor Seligman has put forward the suggestion that the advances of the United States to the Allies should not be treated as debts, after the date of the entry of the United States into the War, and that such "loans" should more properly be viewed as the American contribution to the pursuit of the common purpose.[2] The internal moratorium during the early stages of the War has been paralleled by the Hoover International Moratorium. Self-interest will not brook consistency. A nation which delays or discusses the repayment of its War debts is horrified at the immorality of such means in regard to reparation payments. Discussion is viewed as a face-saving device to disguise a precipitate repudiation. The tortuous devices of modern diplomacy to revise the War debts, to review their character and origin, to classify them according to their relative equitableness, and to gain time for repayment, all come to the same thing. An economist recently asserted "We are all Bolsheviks now," as regards War debts.[3]

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[1] J. M. Keynes, *Tract on Money Reform,* p. 68.
[2] *Studies in Public Finance,* 1925, p. 40.
[3] Dalton, *Unbalanced Budgets,* p. 451.

The New Drift.

Plans of national recovery necessitate public intervention in private property and contracts. The right of the State to legislate on Contract, to protect the weak or to safeguard the interests of the State, has been boldly asserted and freely exercised. The law of insolvency, the proposal to abolish imprisonment of civil debtors, legislation to protect agriculturists from usury, and to secure the rights of tenants against landlords, as well as to prevent land passing into the hands of non-cultivating owners, are all examples. The necessities of the modern fisc know no law, and compromises on fundamental ethical principles are sought to be justified by reference to an empty treasury or to an inevitable social expenditure. "In Finance (as in Politics) the degree of regard to be had for treaty relationships and to economic necessity has become a problem in the art of compromise".[1]

[1] B. K. Adarkar, *Problems of Federal Finance*, 1933, p. 168.

III.

The Background of Reform.

The New Order.

We may begin by taking note of certain recent changes in national outlook and social balance. They now regulate and determine policies of taxation and public expenditure.

The War showed that no country can protect itself against a cessation of the flow of goods from abroad during such a crisis. Its first lesson was the need for economic self-sufficiency. So was it in the past. The Napoleonic wars produced the first notable scheme of the 'self-sufficient State'. Nationalism follows closely on the steps of wars waged against powers claiming or attempting universal dominion. A feature of contemporary politics is the multiplication of small national States, each of which aims at economic self-sufficiency. A tendency to vertical divisions now operates against the movement for international economic and political co-operation. National policies have to adjust themselves to world movements, and International Planning cannot overlook the increasing fervour of national feeling in the after-War Sovereign States.

The persistence of 'War Socialism', after its immediate purposes were achieved, is another disturbing factor. Government intervention in economic affairs is increasing with the gradual disappearance of the dualism between Government and People. The first need for public intervention springs from monopolies. They have grown enormously in modern times, and threaten

political security. Economic life is becoming standardised and centralised. The old argument of the superior elasticity of private over public management is losing force. Routine and rigidity are now as often found in private business as in public undertakings.

The State in Economic Life.

Business now imitates Government, and Government is going into business. We have a new rivalry between the two. Business men accordingly are turning to politics. The Socialist demand that the State should distribute the national dividend has roused dormant interests. Political parties are tending everywhere to become 'economic groups decorated with old political symbols'. Attempts are being made to enlist Government support for sectional interests and special purposes. This tendency has to be checked. The extreme wings of both Communism and Individualism strive to undermine the power of the modern State. Mass movements and the dread of vested influences are strengthening the popular demand for Planned Economy. The Conference of Economists, which met at Milan in 1932, to study 'the function of the State in economic life', was nearly unanimous in making such a demand. The German economists, who attended this Conference, foreshadowed a series of foreign trade monopolies like those in Soviet Russia, as the natural outcome of present tendencies. The Danish delegates concurred in this view, but perceived an increased risk of war in the establishment of national monopolies. The general feeling was expressed by Dr. Dalton: "We are in a State of unstable equilibrium of State functions and of national economic structures. Governments must now either do more or less than what they are attempting."[1] The Italians

[1] *'The State in Economic Life'*, 1933 (League of Nations), p. 22.

explained that the Corporative State was trying to bring about a reconciliation between private enterprise and public control, by a system in which the producer is not allowed to remain indifferent to the ends of production, and the banker to the success of his investments, and every enterprise is compelled to bear the consequences of its own mistakes without shifting its burden to society. The State is to see that the community is not exploited by the relentless pursuit of individual self-interest. The drift of the new movement is clear: the nation which aims at economic self-sufficiency is to regenerate itself by Planning. The lesson of such discussions has not been missed by the Indian publicist.

Obligatory Expenditure: The Burden of Armaments.

The first business in Finance is to get a clear idea of the essential expenditure, for which the necessary resources must be found at any cost. The obligation springs from circumstances which are internal as well as external. No nation can now stand apart and plan its budget, ignoring movements outside its territory. This is particularly the case with military expenditure. The crushing weight of the burden, during the last forty years, has led to the movement for general disarmament. The League of Nations was primarily constituted to make the settlement of international differences possible without resort to war, and enable nations to limit their armaments to the needs of internal security alone. The League has not fulfilled the hope. A caustic critic has remarked (reversing the Latin saying) 'If you want war, make a treaty of peace'. Aggressive nationalism has followed the Peace of Versailles. The rumblings of war have not ceased. The failure of the League to police the World has been repeatedly demonstrated. The military burden lies now more heavily on nations

than it did before the War. The War created colossal debts, and the peace has brought in huge bills for pensions and reconstruction. Lord Hugh Cecil stated in 1927 that out of every pound of tax paid in Great Britain 14 shillings represented the cost of past wars or the preparation for future wars.

Ideals of the Civic Minimum.

External forces influence a country's expenditure in another way also. Barriers are ineffective against an invasion of ideas and ideals. A world conscience, with a world standard of social rights and duties, is being evolved. A cure for the economic and social ills of every country is demanded not only by its own people but by the public opinion and the public conscience of the articulate World. The qualification for entering the comity of nations is now the possession of such standards. A country which gradually sinks "into a kind of rural slum, definitely below the general standard of living in most of the World, a reserve of cheap labour, whose people and whose products will be excluded by countries wishing to maintain a higher standard", has now indeed a bleak future. India is in this position. If she wishes to reach the World level she should first raise her economic standards. Herein lies the crux of the Indian Emigration problem.[1]

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[1] Among the many causes which have contributed to making the 2½ millions of Indian emigrants unwelcome in all parts of the British Empire, this dread of their importing into those countries a low standard of life stands out prominently. To-day no country will have the Indian emigrant on terms which will satisfy India's national self-respect. The penalty for past neglect of the economic uplift of the masses is repatriation, at the expense of the State, of the Indians who are driven out of their motherland by the lack of opportunities for legitimate growth. In 1930 as many as 70,000 persons had to be repatriated from one country alone, *viz.*, Malaya.

Eighteen years ago, Mr. W. H. Moreland wrote (*Quarterly Review,* April 1917): "The standard of life in India is undesirably low. While the masses are provided with the necessities of a bare subsistence,

Optimum Expenditure.

The idea of 'optimum' (*i.e.*, the maximum satisfaction) is as applicable to public as to private expenditure. It has been worked up, on the theoretical side, with considerable analytical skill, in some modern treatises on Public Finance.[1] It is enough to sum up the results. An individual gets more satisfaction by making a reasoned distribution of his resources, on different items of expenditure, so as to secure a balance between them, than if he acts otherwise. He should aim at so regulating the disposal of his resources between different uses, as to obtain an equal marginal satisfaction from each of them. Similarly, a community, acting through its Government, must adjust its income to different public uses, so as to secure the same marginal satisfaction, in each case. The efficiency of such adjustment will depend on the extent of the co-ordination between the community and its Government, and the degree to which the latter fulfils its function as 'the brain of the community'. To illustrate: "Expenditure should be distributed between battle ships and poor relief in such wise that the last shilling devoted to each of them yields the same real return. We have here, so far as theory goes, a test by which the distribution of expenditure along different lines can be settled".[2] As in private life so in

they are in far too many cases badly housed and badly clothed, badly doctored and badly taught, often overworked, often underfed. The present income of the country, even if it were equitably distributed, could not suffice to provide the population with even the most indispensable elements of a reasonable life." "The years pass, and yet every annual official review of Indian administration repeats the above confession. It is significant that since 1916, the obligatory annual report on Indian Administration, has ceased to be called the 'material and moral progress report'."

[1] *e.g.*, Professor Pigou's treatise, and Professor Luigi Einaudi's *"Ottima Imposta"*. See Mr. F. C. Benham's article in *Economica*, November 1934, pp. 436-458.

[2] A. C. Pigou, *Public Finance*, 1929, p. 50.

Public Finance, the allocation of resources to uses will be determined by a capacity to visualise the future, and balance remote as against immediate satisfactions, and one's own gratification as against the satisfaction of others. The disposition of an individual to devote the fruits of his labour or saving to uses which will bring a return only to his descendants, will depend on the intensity with which he is able to identify their satisfactions with his own. The capacity to discount the distant future in this way is not to be found in all men. "The free play of self-interest will cause resources to be turned, more than they ought to be—maximum aggregate satisfaction being taken as our goal—to the use of immediate consumption, and less than they ought to be to the use of distant consumption."[1] There will be a similar difficulty in the balancing of individual and collective satisfactions. A Government will not therefore be simply an agent to carry out the separate wishes of its citizens for the furthering of uses, which will increase their individual satisfaction to the maximum limit. It will act as the agent of all its citizens collectively, and exercise coercion upon them individually, to control personal uses, to bring about the highest collective satisfaction,[2] and to effect a distribution of public expenditure to this end.[3] The *optimum* amount of Government expenditure is likely generally to be greater, the greater is the aggregate income of the community, and less, the less is the income of the people, as for example after an exhausting war or a natural calamity. Again, other things being equal, when an opportunity occurs to reduce widespread social evils by public expenditure, and corresponding opportunities for private expenditure

[1] A. C. Pigou, *Public Finance,* 1929, p. 119.

[2] *Ibid.,* p. 52.

[3] *Ibid.,* p. 51.

are not present at the same time, the advantage of public expenditure for their removal is greater. Further, the marginal damage involved in raising a tax will be greater, when it strikes rich and poor in given proportions, the less equal is the distribution of income in the community. These principles lead to two theoretical conclusions: that a State may properly incur larger expenditure than it does, (1) the *less* even is the distribution of income among its people, and (2) the more *progressive* is the taxing scheme which it follows.[1]

The Population Problem.

The Nation's optimum is thus a function of its economic and social conditions, in which population must figure prominently. The economic implications of the growth of population in India during the last fifty years have to be considered in this context. The *real* increase in numbers (*i.e.*, after allowance is made for differences in methods of computation and the enlargement of territory after the census of 1881) works out at 85 millions for India, *i.e.*, to a 30 per cent. increase in half a century. For an economically backward country like India the growth may be regarded as unduly large. The highest number which a square mile in Europe is regarded as capable of supporting is 250; the estimate for America is somewhat higher, and for a non-European area like Porto Rico, it is given as 400. Such limits are passed in many parts of India. In an Indian State like Travancore or Cochin, the density is excessive, and is accounted for, among other causes, by the fertility of the soil and the availability of cheap food like fish and tapioca which are suited for a low standard of life. Recent studies of the Indian population have led to the fear that, taken as a whole, the population is

[1] A. C. Pigou, *Public Finance*, 1929, p. 52.

permanently on the verge of starvation, and that its further growth without a corresponding increase in productive capacity must react on numbers and efficiency.[1] The conclusions have been criticised on the ground that the general fall of agricultural prices has reduced the cost of living and removed the limit to the increase fixed by the dearness of food;[2] but the criticism fails to meet the point of the argument. A slump is no cure for scarcity.

The Land Problem.

The growth of population has been *one* of the causes of fragmentation of agricultural land, and the increase of the class of landless labourers.[3] Scattered holdings and holdings too small for profitable cultivation are now the bane of Indian agriculture.[4] The size of an economic holding is set by the character of the soil and the crop to be raised on it, as well as by the size of the cultivator's family and their standard of living. Mr. Keatinge estimated it at 15 acres for dry land in the Bombay Presidency, and in the Deccan proper at 40 to 50 acres, "in one block with at least one good irrigation well".[5] Dr. Mann's estimate is 13 acres for dry and garden land in the same area.[6] Professor H. Stanley Jevons considered that the ideal holding should not fall below 20 acres, and Mr. Darling put this limit in the Punjab at 10 acres. Professor Radhakamal Mukerjee puts it at between 4 and 5 acres in the

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[1] P. K. Wattal, *Indian Population Problem*, 1933; B. T. Ranadive, *Population Problem in India, with Special Reference to Food Supply*, 1932; D. S. Dubey, *Journal of Indian Economics*, 1922, III, pp. 84-110.

[2] *India in* 1930-31, p. 151.

[3] Among other causes may be mentioned the Indian peasant's attachment to the ancestral holding and lack of enterprise.

[4] Holdings measuring 1|160th of an acre (reported to be found in a Bombay district) are scandalous.

[5] *Rural Economy in the Bombay Deccan*, p. 52.

[6] *Land and Labour in a Deccan Village*, Vol. II, p. 43.

United Provinces.[1] In many parts of India, caste rules confine industry and stock breeding to the Depressed Classes or to non-Hindus, and market-gardening is not popular. These conditions call for an increase in the size of economic holdings, as the proportion of under-sized holdings is steadily increasing. In England the small holder, who aspires to be better than a farm labourer, needs at least 25 acres for arable cultivation.[2]

A considerable proportion of Indian cultivators have now no economic holding. The fragmentation of holdings is forced by chronic indebtedness and by the prevailing laws of inheritance. A first move in economic uplift is obviously a redistribution of holdings, and a regrouping round a source of irrigation like a well. The work of consolidation has been tried in the Punjab by special co-operative societies with the assistance of Land Mortgage Banks and revenue officials. There has also been a progressive decline in the yield per acre in many parts of India. In the days of Akbar, the yield of wheat in the United Provinces was 1,555 lbs. an acre. It was as much as 1,280 lbs. in irrigated and 840 lbs. in unirrigated land, in 1917, but only 1,000 lbs. and 900 lbs. respectively in 1931.[3]

There are other bad features of the Indian land system which intensify the evil of over-population. They are absenteeism and rack-renting, unlimited sub-letting, rural indebtedness, whose *per capita* burden is now Rs. 30, and non-cultivating ownership.[4]

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[1] *India Analysed*, Vol. III, 1934, p. 177.

[2] G. T. Garratt, *An Indian Commentary*, 1928, p. 29.

[3] Prof. Radhakamal Mukerjee in *India Analysed*, III, p. 169. He estimates the decline in the average yield of wheat as from 760 to 600 lbs. per acre, in the last decade—*India Analysed*, III, p. 211 (1934).

[4] Radhakamal Mukerjee, *Land Problems of India*, 1933,

The number of landless labourers in India is steadily on the increase. It is now about 50 millions. Inter-provincial migration of any appreciable size does not exist. Redistribution of the population is made difficult by the apathy, prejudice and unenterprising character of the villagers. Barring the small numbers who migrate temporarily to industrial centres, the bulk of the landless population remains in the village, and is a burden on the land. In no country of the World with the possible exception of China is land expected to do more than in India. In India poverty is most intense on the country side.

Our immediate need therefore is village reconstruction.[1] The difficulties in the way are great. The apathy of a whole people, whose ignorance and illiteracy prevent them from responding to measures of uplift, which are possible in other lands, has often led to a slide back to the old conditions after official support is withdrawn. This seems to have been the case with the Gurgaon experiments of Mr. Brayne. If the educated classes can be given a rural bias by suitable changes in the curriculum, and can be induced to go back to the village, there may be a possibility of both the reduction of educated unemployment and of village uplift. Similarly, the formation of Co-operative Colonies, like those planted successfully by Sir Daniel Hamilton in the Sunderbans of Bengal, may help.

Waste of Man Power.

The waste of man-power is another misfortune in India. The village cultivator can now utilise only a third of his time and energy. The provision of sub-

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[1] Since the delivery of the lectures, the problem is being attacked both by the Government and by the Nationalists, under the inspiration of Mahatma Gandhi. Mr. C. R. Das urged its need years ago.

sidiary industries in villages will therefore enable him to utilise his leisure. Since the transfer of Industries to the Provinces, some advance has been made in this direction, and it has been furthered by the mixture of sentiment and business underlying the Khaddar movement. Handloom weaving, silkworm rearing, poultry breeding, the manufacture of soap, pottery, bell-metal vessels, shoes, embroidery, and toys are among the industries hitherto tried with success.

Agricultural Progress.

A deplorable feature of Indian agriculture is its burden of unremunerative live-stock. The Royal Commission on Agriculture noted that British India has 61 cattle for every 100 persons, and 67 for every 100 acres, that though it was twice what existed in Great Britain, Germany and Japan, India was lamentably deficient in milk supply and draught power. Religious prejudice restricts the use of bovines to milk and draught only, the consumption of meat being small. This leads to indifference to improvements in the quality of cattle. With the diminution in the size of cattle there is no corresponding reduction in their capacity to consume fodder. In spite of the low value of the work done by Indian cattle to agriculture, their direct services are "reliably estimated" to exceed Rs. 600 crores a year, and the value of the manure and other products of animal origin—such as hides and bones and milk and dairy produce generally, whether consumed in the country or exported—is said to amount to over Rs. 1,000 crores annually. But, as the Indian Banking Enquiry Committee noted, while the Government of the United States of America, which has fewer cattle than India, allots nearly 10 crores a year for animal husbandry, the corresponding expenditure in British India is less than a crore.

The main lines of improvement, which Indian agriculture demands, comprise the propagation of scientific knowledge, the overcoming of scruples regarding the use of animal manure, the conservation of fuel resources so as to prevent the wasteful use of animal droppings as fuel, the use of improved staples and seeds, and the substitution of commercial crops for food grains. There is considerable scope for the improvement of the quality of Indian staple crops, like cotton, tobacco and sugar-cane. Sugar is now the only agricultural product in which the balance of trade is against India, though nearly 3 million acres are under cane. It is therefore attracting increased attention. The experts of the Government have discovered in the Coimbatore hybrid-canes a kind which can raise the acreage yield by 50 to 100 per cent. The establishment of factories for manufacturing white sugar direct from cane juice is necessary to reduce the enormous importation of about seven lakhs of tons of refined sugar. Indian tobacco is inferior in quality to the imported variety, but Virginian tobacco also is now grown in India. The area under tobacco cultivation is about 1 1|3 million acres. Two-fifth of the world's tobacco and nine-tenth of the total quantity grown in the British Empire are produced in India.[1] Very little (two per cent.) of the Indian tobacco is exported, but the imports in 1930-31 were valued at a crore and a half of rupees. It is vulnerable to the charge of being a luxury, and its consumption is inelastic. The consumer purchases it in small quantities, and even in the countries, in which it is steadily consumed, the aggregate *per capita* consumption for a year does not exceed 4 or 5 lbs. The tobacco habit spreads. High *ad valorem* duties are accepted with less reluctance than in cases of other

[1] The sugar imports into British India have steadily gone down. They amounted to only 2,23,000 tons in 1934-35. The credit of the reduction is claimed for the Sugar Industry Protection Act of 1932.

commodities of common consumption. All these features make tobacco a suitable object of taxation. On the present area alone, the yield of an excise on tobacco if it could be imposed, will be very satisfactory, and amount to several crores.[1]

Industries.

The proportion of the Indian population engaged in industry excluding transport is only about one-eighth of the total. Nevertheless, as this number exceeds 15 millions, India is ranked among the eight important industrial States of the World. Prior to 1880, there were hardly any organised industrial concerns in India. The growing importance of industries and the hope that with the introduction of rationalisation, the productive capacity of India would increase, has led to Government action in promoting the advent of an industrial regime. After the comprehensive view of the industrial position and prospects in India taken by the Industrial Commission, the Government accepted (in 1919) a direct responsibility for industrial development. In pursuance of this policy an Indian Labour Bureau was organised in 1920, and a Central Department of Industries was created in 1921. The Indian Fiscal Commission was appointed in 1921 to go into the question of tariffs. A Tariff Board was created in 1923, and India now stands committed to the principle of 'discriminating' protection. It has long been known—and it became apparent during the War—that what India lacks for the fulfilment of her

[1] The area under tobacco crop in British India is 1·3 million acres, and the out-turn may be taken as 3,000 lbs. an acre. At current prices, the value of the crop will approximate to 80 crores. Since 1926, the duty on unmanufactured tobacco imported into British India is Re. 1-8 a lb., but Travancore is permitted to import 3·3 million pounds at the concession rate of about 3½ annas a pound. The Indian Taxation Enquiry Committee (*Report,* pp. 159-160) proposed an excise on factory-made cigars and cigarettes only. The net income from such an excise was estimated by Sir Walter Layton at Rs. 5 crores. (*Stat. Commission Report,* II, p. 257.)

industrial aspirations, is not raw materials but key industries and Government support. The war and its offshoot, the Indian Munitions Board (1917), stimulated many Indian industries. The present position of the chemical industries is due to the impetus then given. The success of state pioneering has been shown by the progress of the aluminium and chrome-tanning industries in Madras, and dairy farming in North-western India.

Industrialisation is raising problems of its own. Our factory labour differs from that of the West, being non-urban, migratory and heterogeneous in character. The factory worker has his roots in the village. He is therefore able to stand unemployment longer, and hence the prolongation of industrial disputes in India. The concentration of industries in the big capitals of India has tended to give them a floating population.[1] A Factory Act has been in operation since 1922, a Workman's Compensation Act from 1923, and a Trade Union Act from 1927. But few Unions are registered. The Whitley Commission (1931) suggested improvements in the conditions of labour such as better housing, sanitation, workmen's insurance, etc. The prohibition of night work to women and children, and the fixing of the minimum age for employment at 12, are other improvements then recommended. But a good deal more has still to be done. Industrial development is in its infancy. The machinery used by Indian mills does not require highly skilled labour. Factory labour is therefore recruited from agricultural labour, and not from hereditary craftsmen.[2] The bulk of it is unorganised, underfed and riddled with disease.

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[1] Only 16 and 25 per cent. of the inhabitants of Bombay and Calcutta are born in these cities.

[2] "The factories collect the surplus population of villages, unsettled

Irrigation.

The improvement of production depends on the proper utilisation of natural resources, including sources of Power. The reclamation of desert areas has been rendered possible by the great irrigation works, which impound and distribute the water that would otherwise have run waste. The Punjab has benefited more than other provinces from irrigation development, but Madras, the United Provinces and Bombay have also had their share. Roughly, a seventh part of the area under crop in British India is now watered by public irrigation works, the area so benefited measuring about 32 million acres, and the total value of the crops 137 crores, *i.e.,* 10 per cent. more than their *capital* cost. The *net* return from capital invested in these works is now 5·4 per cent. which makes them a paying proposition.[1]

Fuel Supply.

Civilisation, in Liebig's happy phrase, means economy of power. Fuel considered as a source of power has received widespread and competent attention in the

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tribesmen, superfluous agriculturists, Hindu widows and the like. These herded into a single room tenements endure the disadvantages of barrack life, without its cleanliness and discipline." (Thompson and Garratt, *British Rule in India,* 1934, p. 596.)

[1] The return will be much higher when the big projects of Sukkur and Mettur begin to yield an income. The Lloyd Barrage at Sukkur is to supply water to 1·85 million acres, which are now inadequately watered, and bring 3·32 million acres of new land into cultivation. Out of the 5 million acres which the Sutlej Valley Project is to command, the area of *desert* reclamation will be 3·7 million acres. The Cauvery Reservoir at Mettur is to strengthen the existing irrigation of a million acres, bring 3 lakhs of acres of new land into cultivation, and produce 1½ lakhs of tons of paddy. The Sarada Irrigation Works in the United Provinces will make 1 1|3 million acres and pay 7 per cent. on their cost. The Bhandhardara Dam and the Lloyd Dam at Bhatgar in the Deccan will irrigate half a million acres. The estimate of income presumes the end of the present depression.

West. The Indian Industrial Commission considered the question from this aspect.[1] The development of industry in India depends upon accessible fuel or other sources of energy. But our fuel problem is not merely one of power supply. It concerns life itself. The heaviest demand for fuel in India, as elsewhere, is for domestic use. The industrialisation of the country and improved standards of life will both contribute to an increase in the demand for fuel. India has collieries, but their ownership, location, quality, and manner of exploitation do not now enable their products to reach distant consumers. A third of Indian coal is used up by railways, a fifth by steamers, and a sixth alone by industry. Only one-eighth of the coal produced in India meets the demand of both small industries and domestic uses, and another eighth is wasted near the collieries. The pressure of domestic demand is therefore concentrated on wood-fuel. The aggregate daily demand for fuel for domestic purposes, estimated on a *per capita* consumption rate of 2 1|2 to 3 pounds a day, would mean for the present population of the Indian Empire about 180 million tons of fire-wood or its equivalent per year. India's forests can now hardly meet more than *two per cent.* of this aggregate domestic demand. Increase of population will swell this demand for domestic uses alone. It will also directly bring about an increased demand for fuel for brick and lime-kilns, needed for new houses. The conservation of our fuel resources, the provision of alternatives to wood fuel, the prevention of the wasteful use of cattle manure as fuel, the use of liquid fuel and the substitution of electrical energy, wherever it can be generated from natural sources, are important commitments of the future. Our forests, apart from

[1] See my *Indian Fuel Problem*, Allahabad, 1919.

their value in storing and conserving water and protecting soil, have to be developed for increasing their fuel yield. The present expenditure on conservation and siviculture is inadequate. The demand for arable land prevents an extension of afforestation. The forests now yield only a nominal surplus revenue of about two crores of rupees. If they are to meet the future demands for fuel and timber, and also become sources of adequate revenue, it will be first necessary to spend considerable sums on their development. It has been recently stated that they can be made to give about Rs. 50 crores to the fisc, if the Government will finance some big schemes of development.[1]

Electricity.

Hydro-electric schemes are still in their infancy in India.[2] Fifteen years ago, an investigation of the water power resources of India was undertaken by the Government, and special reports were published (1919-1921). Since then, among completed schemes of British India the most important are the Bombay Hydro-electric works at Lonavla, the Pyakara scheme in Madras, and the Mandi scheme in the Punjab. Some Indian States have developed schemes of their own. The preliminary investigation made in 1920 showed that only one-fourth of the industrial energy of Indian factories was supplied by electricity, and that from even the sources then in existence twice the quantity of energy required for all factories could be supplied. This was

[1] Gyan Chand, *Fiscal Reconstruction in India,* 1931, p. 116. The estimate appears excessive, and is not supported by data.

[2] Only 300,000 K.W. of water-power plan had been installed till now (1934) in India. It represents only 7 per cent. of the World's installation, of 39·2 million K.W. A recent estimate (published in *The Hindu* of 22—5—1935) gives the potential hydro-electric power of India as 28 million K.W. A comparison with the following figures for 1934 will be instructive: U. S. A., 11·8 million K.W.; Canada, 5·25 million K.W.; Italy, 4·34 million K.W.; and Japan, 3·1 million K.W.

exclusive of the power which might be developed from the big rivers. Each of the seven rivers flowing east of the Indus has been estimated as capable of giving not less than 3 million horse power of energy for every 1,000 ft. of fall from the Himalayas. The future of industry in India, the electrification of our railways, and village and city improvement, largely rest upon the full exploitation of such sources of energy. Their provision will largely increase our future development estimates. The Soviet has wisely begun with developing its electric generation plant. Some of the biggest electrical installations of the world are now reported to be in Russia.[1]

Roads.

The development of communications will continue to have for India important social, economic and political consequences. A sense of unity has largely been brought about by the improvement in communications, which has broken down the isolation of province and province. Railway travelling has also reduced social barriers. "The 'motor age' is likely to have even more profound effects upon the life and habits of ordinary people than the 'railway age' did before it, owing to the greater range and mobility of the new method of transport".[2]

The revolution has only begun. It has already attempted a transformation of rural India. The range of interests of the villager is now wider, and he is being brought into increasing contract with the social and political movements outside. He has gained access to contiguous markets. He is able to dispose of his surplus produce and to obtain some knowledge of price

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1 M. I. Cole, *Twelve Studies in Soviet Russia,* 1933.
2 *India in* 1930-31, p. 265.

fluctuations. Famine is no longer the terror it was. Ease of distribution now-a-days enables local scarcity to be corrected promptly and effectively. The old famine mortality is a thing of the past, which cannot recur. But, if the size and population of India are considered, the existing provision of communications is transparently inadequate.[1] The Jayakar Committee has urged a great extension of road-making in the interests of rural development, increased production, political union, social progress, and railways. For financing road development, the Committee suggested a Road Development Fund, which was to operate on the proceeds of a sur-tax of two annas per gallon on the petrol excise and customs duty.[2]

Motor Taxation.

The total number of all classes of motor vehicles registered up to the end of March, 1930 was 192,690 for the provinces of British India, and it had increased

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[1] In 1927 the mean mileage of surfaced and unsurfaced roads was only ·18 of a mile per square mile of area and ·779 of a mile for a thousand persons. India has 59,000 miles of surfaced road and 40,000 miles of railroad.

[2] The Legislative Assembly sanctioned the diversion in 1930 of the addition of 2 annas per gallon on the import and excise duties on motor spirit, which had already been effected in March 1929, being in the first instance maintained for a period of 5 years and the proceeds of the sur-tax being credited as a block grant to a separate Road Development account, with the proviso that the unexpended balance should not lapse at the end of the year. It was further provided that 10 per cent. of the grant be retained by the Central Government for meeting administrative expenses, research and special grants. The balance is to be distributed to the provinces in the ratio of their consumption of petrol during the previous year. The principle of distribution which is laid down is unsound, if the object of the fund is to extend communications and not merely maintain in a motorable condition the existing roads. The consumption of petrol in a province, excluding the demands in urban areas, is conditioned by the scope for motor traffic, which in its turn depends on the length and quality of the available roads. The distribution should therefore take account of the inequalities in road development, which are now glaring between provinces, and endeavour to correct them.

during a year by 20,000. A consideration of the bearing of cheap and rapid transit on plans for increasing the country's productivity may justify a reduction in the luxury tax of 30 per cent. now imposed on all motor vehicles. The sur-tax on petrol may be open to criticism but for its reservation for road development.[1]

Railways.

Of the available means of transport the Railways are the most important in view of the great distances to be covered in India. Their importance to the country is signified by the repeated State inquests into railway policy and working. In 1872 the total railway mileage of India was 5,300. By the end of March, 1930 it was nearing 42,000. In spite of the efficiency and comfort of India's long distance railways, they must be considered as insufficient for the present and progressive needs of India. Nothing has done so much to break up the ancient isolation of the Indian village than the railway. It has filled villages with small industries. It has made it possible to utilise cheap machinery in the primary manufacturing processes of agricultural produce. The significance of railways and motor communication is seen no less in their psychological than material effects. Rural prosperity in the twentieth century is largely due to, and is evidenced by, the increased use of railways. The consumption of cheap luxuries like mineral water and cigarettes, the exportation of food grains, the increased use of fertilisers, agricultural implements and selected seeds and seedlings, and the rise in wages are among their other results. Rural prosperity increases the membership of

[1] The production of automobiles in India will be the only effective solution of the problems of cheap transport. It will also help in the rationalization of agriculture and in the reduction of the cost of mechanization in the Indian Army.

co-operative societies and Savings Bank deposits, and gives the country the strength to resist the scarcity following seasonal vicissitudes.[1]

The Transport Problem.

The improvement of inland waterways, coastal shipping, harbours and civil aviation is urgent. India's connection with the world is based on ocean and air transport. The absence of commercial fleets owned by Indians, and the discriminations in shipping rates, often made without scruple or knowledge, have impeded India's receiving the full benefit of her foreign trade. Even the control of the coastal trade, which is admittedly essential to India, is now denied to her.

A comprehensive view of the problem of Indian Transport is necessary. Railway policies have to be related to the growth of alternative modes of transit, *e.g.*, road, motor, inland and coastal water vessels, and commercial aviation, and there is a growing need for the machinery, which will effect the co-ordination.[2] The attitude of the Indian Government towards the management of railways has not yet been finally defined. Only ten years ago, the Commerce Member, Sir Charles Innes, made the assertion in the Legislative Assembly: "As India becomes more and more democratised, she will find the State management of Railways more expensive, more and more inefficient as every other country has found it."[3] In other countries, a pull between commercial and political demands has indeed come in the wake of democracy and State management of railways.

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[1] Dr. Marshall, *Official Papers*, p. 353, contends that rural populations probably now bear less onerous rates than is ordinarily supposed.

[2] Nalinaksha Sanyal, *Development of Indian Railways*, 1930, p. viii.

[3] *Ibid.*, p. 228.

Political interference has made the working of the State railways in Africa uneconomical and inefficient.[1] As yet, there are no vested interests in India with sufficient influence in the Legislature to deflect railway policy to directions detrimental to economic working. The fire of the Legislature will probably be concentrated on Indianisation and Commercialisation (advocated by Priestly in 1903) and the substitution of social for economic advantages in the lay-out of new lines. During the War, it was discovered that India hardly produced any of its railway supplies. The making of locomotives in India may therefore be resumed. Big expenses on improvement will probably not take hereafter the form which the five year grant of 150 crores made in 1922 took, *viz.*, the erection of unnecessary station buildings of cement and steel. Linking up of lines, standardisation of rolling stock and uniformity of gauge for the main lines (so as to avoid transhipment, delay, detention of rolling stock and increased expenses) are pending improvements. The amenities for the third class passengers, who provide 90 per cent. of passenger fares, will have to be increased even on grounds of sound economy.

Public Health Reform.

Turning to the moral and social side, the needs of progressive India are three. They are: the conquest of the diseases, which increase avoidable mortality and enfeeble the working classes; the conquest of illiteracy; and the removal of social obstacles to progress. Among the last, are keeping vast numbers in a position not far removed from servitude, the backwardness of women, and child-marriage which leads to race-enfeeblement. The correction of the ravages of preventible

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[1] Herbert Frankel—*Railways in South Africa,* 1928, *passim.*

disease must be taken up first. People must live. Disease has alarming economic consequences. It lowers vitality, increases the death rate and reduces the productivity of the people by diminishing their number, strength and stamina, and reducing their working days. High mortality in the villages leads to frequent changes in ownership of land, to fragmentation of holdings and to indebtedness arising from frequent funerals. Cholera, small-pox, malaria and dysentery, typhoid fever and kala-azar are now endemic. Plague which first made its appearance in India in 1896 has led to vast losses. An expert calculation[1] has put the death from preventible diseases at between five and six millions a year, the loss of working days to each person from the same cause, at between two to three weeks, and the reduction of efficiency through malnutrition and disease at not less than twenty per cent. It has also shown that the percentage of infants in India, who reach a wage earning age, is only 50, though it is possible to raise it to 80 or 90. It is maintained "that the wastage of life and efficiency which results from preventible disease costs India several hundreds of crores, excluding suffering which affects millions. The greatest cause of poverty and financial stringency in India is loss of efficiency resulting from preventible diseases. *Therefore, lack of funds, far from being a ground for the postponement of enquiry is the strongest reason for the immediate investigation of the question.*"[2]

What is now being done in India to reduce disease and disablement is very inadequate, if the magnitude of the task is considered. It now takes the form of feeble attempts at sanitation, medical relief in hospitals

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[1] By the All-India Conference of Medical Workers in India, December, 1926.

[2] *India*, 1927-28, p. 199.

and dispensaries and spasmodic surveys and propaganda. A good deal is left to private agencies.[1] India needs a 'drive' against disease on a vast scale. The movement will fail if the people themselves are not taught to fight disease. The work must begin in the village[2] and must first attempt to remove the villager's ignorance.

Education.

The drive against illiteracy derives its impetus from both political and economic necessity. Democracy postulates an educated nation. Representative Government is meaningless if the suffrage is limited to a small percentage of the population. Without the wide enfranchisement, which will secure popular backing to public measures, it is idle to expect either the formulation or the implementing of courageous schemes of reconstruction. The poison-roots of illiteracy spread far and wide. On the economic side, the general effect of improved education is an increase of vertical mobility, *i.e.,* the movement of workers from low-paid to well-paid occupations. Education combats the tendency of monopoly to restrict entry into particular occupations, by caste or by invidious rules.[3]

Education alone can remove the social and economic depression, which is being unsuccessfully attacked by other agencies. In whatever direction we

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[1] The Indian Research Fund Association started in 1911, gets an annual Government grant of Rs. 7½ lakhs and has done good work, and the Indian Council of the Empire Leprosy Relief Association inaugurated in 1925 has an endowment of 20 lakhs, yielding an income of a lakh a year.

[2] Better housing, proper drainage and unpoisoned water-supply must be provided for every village. The floors, the roofs, the walls, the drains and the surroundings of village dwellings must receive the attention which will prevent their harbouring the germs or the spreaders of disease which enfeeble or kill.

[3] Hugh Dalton, *Inequality of Income,* 1920, p. 267.

may turn—be it to rural sanitation, control of epidemics, reduction of debt, industrial co-operation or improved cultivation—the obstacles to progress will be found to be ultimately due to ignorance. This is the reason why compulsory education must have the first place in national programmes. The ideal has been regarded as an impossible one in the existing conditions of India. Official hesitancy has sometimes found support in the dislike to the use of coercive methods implied in it. Criticisms of the scheme usually miss the two important economic advantages flowing from it. Schemes of compulsion include a period of minimum retention in school, sufficient to ensure permanent literacy. Compulsion makes for economy, as it gathers pupils in suitable schools and prevents overlapping and wasteful competition, which not only increase the expense but lower the tone of elementary education. Mr. Gokhale, in the acuteness of his disappointment at the slow pace at which education was then progressing, declared in 1911 that, at that rate, it would take centuries for all children in India to get primary education.[1] To-day, the expenditure on education is only 6 per cent. of the aggregate central and provincial expenditure of the Government. While Great Britain spends 15 shillings per head on education, the corresponding figure for India is only 6 pence.

We have also to face the problem of adult illiteracy and ignorance. Their correction is the need of the moment. Some capacity to exercise the vote, such as education might give, is needed for the newly enfranchised. Adult illiterates consist of those who have always been illiterate, though they have had opportu-

[1] The percentage of literacy to population has hardly increased by one per cent. between 1921 and 1931.

nities for education, those who have had no opportunity for education, and those who have relapsed into illiteracy.

There are special difficulties in India besides the financial, which impede the spread of education. The poverty of the masses, inadequate means of communication, social tradition confining literacy to certain castes or groups, and the chasm between rural and urban life, are some of them.[1] Again, women, who form 75 per cent. of the teachers in primary schools in Western countries, are not available for the work in India. Social customs in many provinces compel the seclusion of women, any occupation outside the home being regarded as improper or undignified.

Education is not regarded in India as the national investment it is deemed to be elsewhere, *i.e.,* in the sense that the educated person goes back to the village and spreads the light among the villagers. In most countries, East or West, teaching is the mission of religious bodies, which draw their recruits from the educated members of the community. This was so in India formerly, but it is no longer so. An effect of the spread of individualism in recent times has been to throw the whole burden of Education on the secular State. In other countries, the landed interest gets educated, and renders great service to the spread of sanitation and education, but it is not so in India.

Our educational problem is thus very complex and difficult. A system of universal education can perhaps be devised for India but it can be done only by an outlay far beyond her present means. To secure even *nearly* universal literacy, within a period of 10 or 15 years, an addition of Rs. 20 crores must be made to our

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[1] *India,* 1924-25, p. 273.

educational budget. In countries like Great Britain, Education has figured conspicuously in party programmes. In spite of the claim of the May Committee[1] that the standard of post-War education, which the poorer children receive, is, in many cases, superior to that which the middle class parent is providing for his children, and the consequential recommendation that there should be a pause in the policy of further educational expansion till an endeavour is made to reorganise the system on more economic lines, Radical and Socialist opinion in Great Britain continues to press for a further rise in the school leaving age to sixteen—an ideal inconceivable in any compulsion programme that India may adopt.

The Depressed Classes.

The 'Depressed classes' form an economic and political drag on India. They form about a sixth of the population of British India. Their disabilities range from discriminative treatment in social life, galling to self-respect, like untouchability and exclusion from the highways, tanks, wells, etc., to real serfdom.[2] The psychological changes which have been taking place in India have not left the Depressed classes unaffected. Much of the Hindu-Moslem tension has been officially attributed to the surviving resentment against the social oppression, which drove the Depressed class Hindus to Islam.[3] Poverty, insanitation, illiteracy and other evils leading to physical and mental starvation and

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[1] *Report of the Committee on National Expenditure,* 1931, para. 502.

[2] Fifteen years ago, the settlement reports in the United Provinces and Bihar revealed the existence of serfdom and the custom of the mortgage of personal liberty by agricultural labourers.

[3] This view is challenged, and the tension is more correctly attributed to the sharp differences in the religious beliefs and customs of Hindus and Moslems.

economic inefficiency are most intense among these classes. The great movement, which is now spreading, for the extension of equal social rights to these classes, touches only the surface of chronic and deep seated trouble, which is fundamentally economic. The plans for the relief of the landless cultivator, for village reconstruction, for industrialisation, and for compulsory education and sanitation, will benefit this portion of India's population more than any other. An improvement of their condition will have two effects. Firstly, it will prevent the disproportionate increase in that part of the population which now acts as a drag, for, "an improvement in the economic welfare of any class tends to lower rather than to raise its rate of numerical increase".[1] Secondly, it will diminish the heaviest demand for drink, which now comes from the half-starved population.

The New View.

The precedence given to types of the demand for expenditure, which relate to economic and social reform, over those which are obviously required for carrying on the government, is the logical corollary of the modern revision of the views of social responsibility. The trend of the times is to emphasise the humanising duties of the State. The chief obstacle to their proper discharge is now the cost of armaments. The reduction of this uneconomic and unsocial burden is possible only by international agreement. The social reformer therefore appeals to world conscience as well as to national governments.[2]

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[1] Hugh Dalton, *Inequality of Income,* 1920, p. 11; A. C. Pigou, *Wealth and Welfare,* pp. 28-31.

[2] See Sir Walter Layton's views on the subject in the *Statutory Commission's Report,* Vol. II, part viii. They have been criticised in the concluding chapter of the Official Memorandum on Indian Army Budget, published in the newspapers in March—April, 1934.

A brief reference is due to other items of National expenditure, which are less onerous. The central and provincial expenditure of a typical year, *e.g.*, 1929-30, will show the approximate relation of the different items in India. Out of an aggregate bill of 226·21 crores, the Defence expenditure accounted for 27 per cent., the Debt services for 9 per cent. and Development expenditure only for 14 per cent. The intractable items of Indian Finance are the Military expenditure, the cost of the General and Central administration, and the Interest charges on the Public Debt.

Military Expenditure.

There are many who regard armaments as wholly evil. This is an extreme view. It overlooks the need to be prepared for defence, the fact that preparedness is not identical with war, and the circumstances that to run down defence arrangements is like condemning the maintenance and the equipment of the police. Security from external aggression is not less vital than internal tranquillity. But, there is primary loss in production to which we have to add some indirect loss. The cost of armaments manifestly increases the burden of taxation. The effects of excessive taxation are cumulative, as each rupee of additional tax is harder to spare and to bear than its predecessor. Wars use up irreplaceable natural products. The terrible waste of man-power is obvious. Those who fix their attention only on Great Britain and the United States of America sometimes hazard the generalisation that the countries which have made the greatest strides in economic development are just those in which the expenditure on the army has been the least. They would deny that the case of Germany or Japan disproves their proposition, and contend that these countries would have progressed

even more, if their defence estimates had been pruned. The motive for disarmament is at least partly economic. The stimulus to the growth of armaments comes even more from small political units and the intensification of petty nationalisms than from the desire for colonies or aggressive imperialism. In India, the size of the British element in the army is justified by reference to the risks of communal strife,[1] and the growth of terrorist activities in Bengal now furnishes an additional justification. Internal harmony, if secured, must be admitted as a valid reason for a reduction of the defence bill of India. The lesson is plain: the penalty for strife is economic stagnation.

Certain features of the Indian Army call for attention.[2] The ratio between the British and Indian troops is as one to two; before the Mutiny it was as one to five. A British soldier costs much more than an Indian sepoy and since the War the disparity has widened. In 1913 it was as 3 to 1, and in 1922 4 to 1. A British officer costs six times as much as an Indian officer, and a British soldier costs about three times a sepoy.[3]

The aim of the Army is preparedness for immediate war. Lord Esher's Committee (1921) declared that the Indian Army should be a unit of Imperial Defence and should accordingly be under the ultimate control of the

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[1] "Troops stood by or were engaged in the prevention or suppression of internal disorders on 118 occasions in 1930-31, 103 occasions in 1931-32, and 32 occasions in 1932-33", says the recent official defence of the Indian Army Budget (Ch. II).

[2] The strength of the regular element in the Indian army is now about 194,000 men for all the services. Of these the British troops number 58,000, and the Indian regulars 132,000. The Indian reserves number 34,000 and the European auxiliary forces have about an equal strength. The Indian territorial forces number only 16,000. The combined strength of the Indian State forces is estimated at 36,000. Great Britain in 1931 had 137,000 regulars and 153,000 territorials. The fighting strength in 1933 is given as 183,000 in the above memorandum.

[3] *The Indian Army Budget* (Officially communicated), 1934, Ch. I, para. 2.

British War Office.[1] This has created the feeling in India that the strength of the army is determined less by the needs of Indian than of Imperial Defence. Indian politicians hold that a higher standard is aimed at than is necessary for India. The failure of the Indian army in the Mesopotamian campaign has been referred to to justify a different inference, though the *debacle* was largely due to the bad organization of the auxiliary and ancillary services. Pre-War standards are obviously out of date, and it is reasonable that the Indian Army should be up-to-date in organization and equipment. On this the views of the expert will naturally carry weight; but the lay opinion in India claims that on questions of pay and emoluments (which have been more than doubled since the War, in spite of a fall in prices), and on policies of recruitment and proportions between the British and Indian element, it has to be considered.

The total cost of the British portion of the Army, excluding pension charges and capitation rates, may be taken as about Rs. 13 crores a year. The official memorandum estimates the saving from the *total* disappearance of the British element in the Indian Army at only

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[1] It further laid down "that to the extent to which it is necessary for India to maintain an Army for these purposes (namely for the defence of India against external aggression, and the maintenance of internal peace and tranquillity, its organisation, equipment and administration should be thoroughly up-to-date and, with due regard to Indian conditions, in accordance with the present day standards of the British Army." War experience has compelled radical alterations and improvements in the organisation and equipment of the Indian Army. Non-existant services (*e.g.*, Signal service) have been created, the 'Contract' system for housing and feeding given up, troop lines (costing Rs. 10 crores, maintained at Rs. 12.5 lakhs a year) have been built for the Indian troops, and mechanisation adopted mainly in transport. The present (1934) cost of a British Cavalry regiment is just over Rs. 16 lakhs a year, while that of an Indian Cavalry regiment is rather over Rs. 7 lakhs a year; a British Infantry Battalion costs about Rs. 17.25 lakhs and an Indian Infantry Battalion about Rs. 6.75 lakhs. (The commissioned officers in the latter are Europeans). Between 1914 and 1932, the cost of the fighting services increased by about 50 per cent., though the fighting strength diminished from 238,000 to 183,000.

Rs. 8 crores, excluding of course the cost of pensions.

A curious feature of the Indian Army is that it is not recruited from all parts or communities of India. Thirty per cent. of the area now supplies nearly ninety per cent. of the recruits. This discrimination is based on an assumption, not altogether warranted, that certain elements of the Indian population have alone the martial qualities necessary in the Indian soldier. It involves a reversal of the post-Mutiny policy of ensuring that no class or section was allowed to preponderate in the Army, and the possibility of the creation of "counter-weights" to Indian progressivists in the future, in the growth of classes and areas with military traditions and ambitions.

It is undoubtedly a humiliation for any people, which aspires to freedom, to have to support an army of occupation, over which it has no control. It is galling to national sentiment to accept the view that the defence of India and the settlement of internal disorder necessitate the permanent maintenance of a large British element in its army.[1] The aim of all progressive parties in India has therefore been to Indianise the Army, to reduce the proportion of the 'white' army in the total, to develop Territorial Forces composed of Indians, to extend military training to Indians, to extend the area of recruitment to the whole country, and by stringent economy, coupled with the reduction of the strength of the Army to the minimum required for Indian purposes, to bring about a suitable reduction in the Defence expenditure. To the argument that such a reduction will

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[1] "There is a perfectly natural feeling that until India can stand on her own in the matter of defence, it will be impossible for her to achieve the measure of self-government towards which she is aiming." (*Official Memorandum.*)

weaken India's defence, it is said in answer that, like every other country, India must take risks, and that by the cultivation of friendly relations with other nations, and by the promotion of peace and progress within the country, it should be able to diminish both the necessity for a huge army and the risk of such evils as foreign invasions, even if they do not harden into conquest.

The present scale of the Army and of its charges is defended by a reference to the higher expenses incurred by other countries with smaller areas and populations.[1] The weakness of this kind of argument is that population and area are no proper criteria of military necessity, and that average income is no measure of vulnerability. The argument for *status quo* includes reference to the services to India rendered by the British Navy,[2] the alleged absence in India, as compared with England, of large numbers of young men with long traditions of leadership in the Army behind them, the problem of seniority for promotion, which blocks rapid Indianisation, the monopoly of military aptitudes in the present elements of the Army and the necessity for *British* troops to put down communal riots. The case against Indianisation was sensibly weakened during the War, when in a time of unparalleled stress, British troops in

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[1] France spent £89 millions, Italy £54 millions, Germany £34 millions, the United States of America £172 millions, and Russia £192 millions in 1930-31. "The incidence of defence expenditure in India is Rs. 1-8 per head, whereas in England it is Rs. 30, in the Dominions between Rs. 3-8 and Rs. 8, in France Rs. 29-8, in the United States of America Rs. 18-8, and in Japan Rs. 6-8." (*Official Memorandum,* Ch. V, para. 11.)

[2] The Royal Indian Marine is inadequate for defending the vast exposed coast line of India, as shown by the exploits of the *Emden* in 1914. It had a fleet of only 12 vessels, before the War, none of which was armed or had a personnel trained in combatant duties. Since the War, it has been much improved in efficiency and has been partially armed. A 7,000 ton cruiser and a battleship of up-to-date pattern are estimated to cost 2 and 10 crores of rupees respectively—amounts at present outside India's financial strength.

India were reduced to a fourth of their normal strength. Small details like the dispute over the Capitation charges now paid to the British War Office by India for training the British recruit for service in India rankled, and were points of contention till quite recently. Even the decision taken on the report of the Capitation Rates Tribunal which settled the dispute has only increased the irritation.

In the discussions which foreshadow the impending constitutional changes, the Army has been put first among the 'Safeguards' and excluded from the purview of the Indian Legislature. The decision might have been happier; for, the mixture of power and restriction must court defeat. As pointed out by Sir P. S. Sivaswami Aiyar in 1928, "so long as the subject of military expenditure is not placed on the votes, there will be no opportunity for the cultivation of a sense of responsibility by the Assembly. The submission of military expenditure to the scrutiny of votes of the Legislature will have the further advantage of more careful preparation of the proposals by the Military authorities with due regard to economy".[1]

The Indian complaint is that, in spite of the fall in general prices, there has been no substantial reduction in the Military Budget greatly below the limit of 50 crores suggested by the Inchcape Committee.[2] In this controversy it may be worth while to recall that even the military strength of a country depends largely upon its economic and financial strength, and that from

[1] *Indian Constitutional Problems,* 1928, p. 183.

[2] It is now about 46 crores. The official apologist airily dismisses this criticism in these words: "A hope of this kind is based on the fallacious expectation that a fall in prices will be accompanied by a simultaneous and corresponding fall in wages—an expectation that never has been, and never will be fulfilled in ordinary life." (*Memorandum,* Ch. V, para. 3.)

the purely military point of view some reduction of defence expenditure to improve production and finance *may* be worth while.[1]

Civil Administration.

The present scale of expenditure on the Civil Establishment—Central and Provincial—in the higher grades particularly, is also strongly criticised. The pay and emoluments of the Indian Civil Service and of certain other services are deemed excessive for a country like India, and the high rates are regarded as an evil legacy of the extravagant salaries introduced by Lord Cornwallis at the end of the eighteenth century to check the widespread corruption of the servants of the East India Company. In defence of the existing scales of pay, it is asserted that Europeans engaged in business earn much more, that only forty per cent. of the gazetted staff in India are British recruits, that even a ten per cent. cut of their salary will effect only a saving of 1·6 crores, that if the cut was extended, it will cause discontent, and that the salaries of the Europeans account for only 2·5 per cent. of the aggregate Central and Provincial expenditure. While it may be that the savings from either reduction of their appointments or their replacement by Indians will not provide the large sums necessary for financing development schemes, the existence of a large, highly paid, non-Indian agency in control positions, must continue to be a source of discontent. The moral and political evils of the system are even greater than the monetary loss. The loss to India of the administrative experience acquired in her service by the British civilian who leaves India on retirement, should also be reckoned along with the denial of opportunities for a sufficient number of Indians, to gain the

[1] M. E. Robinson, *Public Finance,* p. 167.

requisite administrative experience (a point recognized by the Montagu-Chelmsford Report). Further, the system creates on the one hand a galling sense of inferiority, which stunts the moral growth of the Indians, and on the other, an irritating spirit of racial superiority among the British.

In spite of the progress of Indianisation and the Provincialisation of many services, and the grant of virtually equal salaries to Indians and Europeans holding the same offices, the resentment in the country is not subsiding. It has led to proposals in the name of the Nation for restricting all public salaries to a maximum of Rs. 500 per month. The liberal concessions made on the recommendation of the Lee Commission to the Covenanted Services, swelled the cost of administration by a crore of rupees. The declaration of Mr. Lloyd George in 1922[1] that the Civil Service of India is the steel-frame of Indian administration, and that at no time could India dispense with a nucleus of the British element in the Civil Service has tended to keep the sore open.[2]

Public Debt.

The economic progress of India necessitates the employment of all the capital in the country that is now idle and all the available capital which can be borrowed cheaply. The credit of British India has been good. India's capital investments have been carefully husbanded. Four-fifths of India's debts are productive and represent solid assets. India has never delayed or defaulted payment of interest or capital. In the London market she has usually commanded more

[1] The pronouncement was made in connection with the agitation started by the famous O'Donnell Circular of May, 1922.

[2] The new Government of India Act has proceeded on the steel-frame theory.

favourable terms than the Dominions or mid-European countries. This is owing to two reasons, namely, the maintenance of large cash reserves and balances in London, and the benefit of the trustee status enjoyed by the Indian Debt. Parliamentary control over the revenues of India and the expenditure of huge sums in the purchase of stores materials in Britain have also proved useful in floating loans. The loan market is sensitive. If nothing happens to create the belief that the Government of India is becoming less efficient than hitherto, its favourable credit in the foreign capital market will be maintained. The amount of foreign capital invested in Government bonds and in private undertakings like Joint Stock Companies is steadily growing. In the decade following the outbreak of the War, the paid-up capital of Indian Joint Stock Companies was trebled, *i.e.,* from 80 to 250 crores.

In spite of the outcry against India's being 'bled white', her potential capital is probably sufficient for her growing requirements.[1] Indigenous capital is shy and conservative, and has to be coaxed into use. Unused capital is lost opportunity.[2]

The reduction of the idle hoards and the correction of the age-long tendency to hoarding and to investment in jewellery depend on many factors. Increased confidence in the Government and public agencies is one of them. The mounting up of the deposits in the Postal Savings Banks and the increased use of the Five-year

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[1] D. L. Dubey, *Indian Public Debt,* 1930, p. 348.

[2] "Idle money means idle manhood. Capital newly invested in India's development means the opening of new avenues of employment. The new capital required must be India's own capital. Given the necessary development of Banking and credit facilities India will be finding capital for herself and even lending it to others." [Sir Basil Blackett in his speech before the Delhi University (November 1925).]

The External Capital Committee of 1925 reported the existence of vast amounts of dormant capital in India.

Cash Certificates are indications of it. Political vicissitudes and fears have a damping effect on both external and internal credit, and India needs stable public credits, which will grow with the needs of the country. The biggest potential banking concern now in India is the Post Office. Through its 20,000 offices, the Postal Department should, under an improved organisation and outlook, be able to utilise the unused capital of India.[1] The new Reserve Bank will prove helpful. For obtaining more capital for India, the Acworth Committee (1921) recommended improved organisation of the agencies for the issue of Government loans, provision of a wider base for them, and the utilisation of the services of all the Banks.

The Public Debt of India comes with the Army and the Civil Service among the safeguards. It has risen from Rs. 510 crores in 1914 to 1051 crores in 1932, and to 1212 crores in 1934, and more than doubled itself in twenty years. The proportion of the Rupee debt had increased during the period from about one-third to about one-half. The short term loans of the Government have proved more popular than long term securities. Forms of loans other than the regular Rupee loans assumed importance in the post-War period. The sterling debt increased from £247 million to £384 millions by 1934.[2] Over 80 per cent. of the Debt is invested either in income-bringing assets like

[1] There are no banks at all in 20 per cent. of towns with a population of 5,000 or more, and 75 per cent. of the towns with 10,000.

[2] Mr. K. T. Shah (in *India Analysed,* II, pp. 125-127) points out that in the Report of the Controller of Currency for 1931-32 the equivalent of £380 millions of the sterling debt is given as Rs. 506 crores at the conversion rate of 18 pence the rupee, and that at the 'more normal rate' of 16 pence the rupee equivalent will be 12·5 per cent. larger. "The real burden of the sterling debt is," he adds, "higher, because of the favourable conversion terms and total exemption from the Indian income-taxation of the Sterling Securities". The repatriation of the Sterling debt was urged in the Council of State on the 28th August, 1934, since on its account 'safeguards' in the new Constitution were demanded.

Railways or in loans made to Provinces, Indian States, etc. Even the remaining uncovered debt (which amounted to only Rs. 208 crores on the 31st March, 1934) has tangible assets to set off against it, and the 'unproductive' debt has been reduced to 7 per cent. of the total. No important State in the World has now a sounder debt position than India. Money could sometimes be more easily raised in India and on cheaper terms than in London.[1]

The foreign debt of India includes investments in Indian industry, plantations and railways. Mr. J. M. Keynes estimated it in 1908 at 350 million sterling. Dr. Dubey estimated it at 600 millions in 1930,[2] apparently accepting Sayer's estimate in the *Financial Times*. An internal debt ordinarily represents only a transfer of wealth within the State, and provides for the employment of idle savings. A foreign debt has a different complexion. More than half the rupee debt is believed to be held by Europeans, and the bulk of the sterling debt is of course held by them too. This necessitates the payment of about Rs. 15 crores of interest to persons outside India. The external capital invested in India also gives rise to the feeling that the country is being exploited. The high dividends paid by undertakings, financed by foreign capital, come in for adverse comment. But, it is not fair to overlook one feature of such gains. They have to be viewed as compensation to external capital for the losses of pioneer industrialism, which fell only upon it, and for the initial cost of developing enterprises, the benefit of which is not now confined to foreign capitalists but is shared by Indians

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[1] *Cf.* D. L. Dubey, *Indian Public Debt*, 1930, p. 42.

[2] D. L. Dubey, *Indian Public Debt*, 1930, p. 3; see also *Economic Journal*, March 1933, which puts it at £575 millions. Dr. B. Ramachandra estimates it at £612 millions in 1934 (*India Analysed*, II, p. 87).

also. The profits amounting to about 16 million sterling annually accruing from invested foreign capital in India may be viewed in this light.[1]

There has been some want of continuity in the loan policy of the Indian Government. Loans have not always been contracted on terms most advantageous to India. The chief hardship from the Debt is less the annual charge, than the creation of powerful interests, which are under suspicion of influencing policy and constitutional development, to their own private advantage. India will require large sums for development expenditure and they must be found by loans. A Board of National Investment, which will classify the different forms of Indian Debt, according to the agencies for whom they are wanted, secure some uniformity of interest rates, and arrange for plans of redemption and sinking funds and for the extinction of unproductive debts, has been suggested.[2] Mr. Gokhale condemned the policy of repaying the productive debt when the same amounts could be better used in development. Modern financial opinion will endorse the view. Unnecessary redemptions often lead to short-sighted economies in social expenditure.[3] There have undoubtedly been instances of almost criminal extravagances in the past. The fears of a repetition are revived when public borrowing is rendered possible without antecedent legislative sanction. Large loans relax the spirit of economy. But they will be the normal feature of India's future Finance. Without *National* backing, neither Loans nor Planned Development will have any assurance of success. The support

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[1] *Report of the External Capital Committee*, 1926, para. 7.

[2] Dubey, *Indian Public Debt*, p. 232.

[3] Dalton, *Public Finance*, p. 249. In 1924 a scheme for the complete redemption of the Indian Debt in periods ranging from 50 to 80 years at an annual charge of about 3 crores was devised by Sir Basil Blackett,

of the country can be expected only when the Legislature controls the Public Loan policy. The pursuit of plans for economic development thus leads in the direction of political autonomy.

Ecclesiastical Department.

The continuance of a small charge of about a third of a crore for the Indian Ecclesiastical Department is not happily conceived. The establishment has existed mainly for the European element in the Army and in the Civil Services. It is not fair that the Government should finance religious ministration to one section of the people alone. The inclusion of this charge in the "safeguards" will cause irritation.[1]

Character of Expenditure Survey.

The survey of the calls for expenditure in India has been limited to the heads which will not be affected appreciably by impending constitutional changes. The latter, when they materialise, will result in a general increase in the cost of the administration consequent on federation, progressive democratization, and the increase in the number of provincial units. Popular government has seldom been cheap government.

Public expenditure will not hereafter proceed on the old assumption that the most urgent calls are those of defence, internal security, and the repayment of debt. The only basis of lasting security is social peace, springing from such a distribution of public resources by a Government as will remove the causes of depression, reduce the number and importance of vested interests, prevent the conflicts which must arise from an economic and social misfit, promote industrial

[1] The new Government of India Act has included it.

harmony, and, by the provision of the civic minimum to every citizen, increase general economic capacity. The attainment of such a balance is an antecedent requirement of the fiscal optimum. To secure it, Public Expenditure, no less than the Public Revenue, should be viewed as a whole, with special reference to balancing competing elements. Balanced expenditure is the ideal on the expenditure side. Harmony of revenue and expenditure, in the permanent interest of the community, is the fiscal optimum. In any effort to extend the social services, if reasonable levels of education and health, and reasonable facilities for all the population in amenities are to be secured in the modern State, large expenses must be faced. If the resources for meeting them cannot be raised by taxation alone, without trenching upon saving and enterprise, "saving and enterprise themselves must become public functions".[1]

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[1] Barbara Wootton, *Report of the Committee on Taxation under Capitalism*, 1934, p. 21, N. F. R. B.

IV.

Review of Available Resources.

Expenditure Basis of Revenue.

If the progress of a country is to be steadily maintained those who govern it must have a clear perception of its economic conditions and needs and a view of its goal.[1] A survey of the resources needed for correcting existing backwardness and evils, and accelerating the pace of advance will be needed. It will be no less obligatory to examine the relative importance of the various improvements, and as the result of such investigations, to ensure such a distribution of expenditure among them as would yield the maximum satisfaction.[2] Fundamental reforms in the social and economic structure of India are among the first obligations and incidents of the New Freedom. They would require the attention of the Finance Minister in the future, no less than the protection of the country from external attack and internal disorder, the maintenance of public credit and the smooth working of the administrative machine. To find resources for them will be his imperative duty.

Classification of Revenue.

The financial resources of a modern State can still be brought under the sevenfold classification of Public Revenue, which has come down from Bodin. Recent financial theory gives prominence to the types

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[1] Vera Anstey, *Economic Development of India,* 1929, p. 478.

[2] The priority given (in our consideration of expenditure) to the functions usually regarded as optional, over those generally deemed obligatory, is aimed at such a balance.

of revenue to which Bodin also gave precedence. The 'landed domain of the Commonwealth', and 'Public Traffic and Trading' are again coming into general acceptance as suitable sources of National income. In a review of the State's income, it is now less necessary to enter into abstract discussion of the 'tax' or 'non-tax' character of its several elements than to inquire into their productivity and effects. A modern Government must secure the resources necessary for the discharge of *all* its functions. In the collection of revenue, the limit of beneficial action is generally supposed to be fixed by the taxable capacity of the people. But, willingness to pay the contributions required by the Government is not less important than ability to pay. New taxation will have to be preceded by an enquiry into the attractiveness of alternative forms of it.

Fiscal Friction.

A man does not part with his wealth readily even for a public purpose, unless its utility is established to his satisfaction. The reluctance is governed by the 'law of diminishing utility'. It will increase cumulatively with an increase in the size of the payment demanded and decrease with a diminution of it. Some friction is inevitable in tax collection. Administrative wisdom therefore dictates the exhaustion of non-tax resources, and of the possibilities of stringent economy, before additional taxation is imposed.

Economy works in two ways. From the standpoint of expenditure, it insists on obtaining the fullest return for outlay. The State must have its money's worth. From the standpoint of income, it endeavours to minimise leakage of taxes and wastage in collection, either due to inefficient administration or the costliness of the collecting machinery. Under the first head come

all plans for retrenchment and for the elimination of avoidable expenditure of every kind. To the second category belong the improvements in fiscal machinery and technique, which will ensure economy and efficiency and will keep down both the proportional cost of the collection and the amount of unexploited taxability. Modern governments, like ancient Rome, believe that 'economy is the biggest income'.[1]

Economy in Expenditure.

The support for economy comes from two directions. It is derived from the old beliefs that taxation is a necessary evil, and that wealth is put to better use, individually and collectively, if left in private hands than under public control. Both these assumptions are now questioned[2] and with justice. Whether a tax is to prove a good or an evil, will depend on the use to which its proceeds will be put. An individual is not always the best judge even of his own interests, and he is usually less able to judge of collective advantage than a neutral (and possibly expert) public body. There are kinds of expenditure, which are beyond the means of private parties, or which cannot be entrusted to private persons. Accordingly, even from the viewpoint of private interests, the provision of certain utilities by the State (in which large-scale production alone can ensure economies) is found to be more advantageous than if every individual had to provide them himself. Education, sanitation and communications, as well as the Post Office, the Telegraph, the Telephone and the Wireless, etc., illustrate this principle. The old preference of private to pub-

[1] *Parsimonia est maximum vectigale.*

[2] They appear to underlie Dr. R. P. Paranjpye's Note to the Report of the Indian Taxation Enquiry Committee, p. 412.

lic agency rested on the assumption that self-interest, alone can furnish the spur to enterprise and economy in private persons, and that it cannot operate in a public body. This view implies a low estimate of public spirit and unselfishness and dependability of State functionaries. Its weakness will be apparent with the progressive advance in the standards of administrative ethics and efficiency.[1]

Implications of Economy—Budget and Audit.

The implications of the national economy are numerous. The separation of the commercial and industrial departments of the State—their budgets, revenue accounts and audit from the general administration is chiefly due to considerations of economy. The differentiation between the somewhat different aims of Commercial and Public Utility Services is also due to it. The review which many States, including India, have undertaken, of their inter-departmental activities, with the object of reducing overlapping, friction and waste, has also been prompted by economy. The separation of the commercial and industrial activities from general administration is a clear gain to both. It enables the results of the working of each department to be seen as they are, and reveals defects which require correction. It facilitates the substitution of the technical expert for the official functionary in managing such departments, and avoids their being placed under civilians. It keeps business and sentiment apart. It gives the freedom to every department which is necessary to induce initiative and resource. Above all, it removes business undertakings from the arena of cur-

[1] The British Committee on National Debt and Taxation (known as the Colwyn Committee) came to the conclusion that 'for many social objects, wise collective expenditure is clearly more economic than expenditure left to the individual'. See its *Report*, 1927, p. 104.

rent politics, and ensures for them continuity in financial policy and administration.

In India some progress has been made already in this direction. The accounts and the audit of several departments have been separated. Since 1924, the State railways are having their own budget, and they are administered under the supervision of the Railway Board, with the help of a special Financial Adviser. The principle that each commercial or industrial department should provide against the calls for periodical renewal of its fixtures and plant and the depreciation of its assets by building up its own Reserves and Sinking Fund, has been accepted for the State railways. The fluctuations, which made for disequilibrium in the general Budget, by the inclusion of Railways under general Administration, are now avoided. By a legislative convention, reached in 1924, the railways are now to make an annual contribution, not falling below a fixed amount.[1] These principles have to be applied to all such departments.

Public Utility Services.

But, what is even more required is a clear perception of the difference in nature and purpose of the commercial and industrial departments on the one hand and the *Public Utility* services on the other. Its absence has led to mistiness in the public mind as to what might be legitimately expected from each of these. A

[1] The arrangement was originally for a quinquennium, subject to renewal. The annual contributions of the railways to the Exchequer were settled as *one* per cent. on the capital at charge in the year before the Convention, *plus* one-fifth of the surplus profits every year. If, after making the above payments, the surplus profits of the railways exceeds Rs. 3 crores, one-third of the excess is also to be paid to the Exchequer. (Vera Anstey, *Economic Development of India,* 1929, p. 140.)

Public Utility is a thing apart from a commercial enterprise. It may be under public or private ownership. Its essential feature is that it performs an economic function. Unlike private business, it accepts the obligation to render reasonably adequate service to all who apply. It should not attach unreasonable conditions to the contracts of service it enters into with the public, in such a way, as to limit its helpfulness. It should serve without discrimination all customers. It must observe great care in rendering its constant and beneficial services, owing to the dependence of the public on its activities. A Public Utility is entitled to collect a reasonable price for its service, and to impose reasonable conditions on its patrons.

The conception of Public Utility is made up of two economic ideas, monopoly and necessity. Where a public undertaking does not restrict the freedom of choice to the people to utilise it, in preference to alternative private undertakings which render the same service, it is not a Public Utility. The idea of necessity implies that the service meets a general need. A Public Utility calls for State regulation or management. The Railway, works of Irrigation, the Post Office are examples of Public Utilities. A State factory or a State workshop, the products of which are offered for public sale, does not come under this category. A State workshop, like an arsenal or a munition factory, does not cater to the public at all. The mixture of the political and the economic aspects makes the regulation of Public Utility a task calling for skill and knowledge. Some of the so-called "Commercial" undertakings in India are really Public Utility services, and they must be administered on principles applicable to Public Utilities. This is implied in a vague way in the demand that in

fixing rates, the public and the business aspects of undertakings like the Railways and the Post Office should both be stressed.

The guiding principle now in the determination of Railway rates is charging what the traffic will bear. The principle has to be applied by private as well as State railways. In its rigour, it implies the extraction of the utmost that can be got out of the traffic. Private railways often forget that a Public Utility should not misuse its powers and discriminate between its customers, to the advantage of some and to the disadvantage of others. The Acworth Committee on Indian Railways brought to notice instances of improper action by 'private' railways of India, in fixing discriminatory rates for traffic, some of which were even aimed at the extinction of particular harbours or businesses. One purpose of State regulation of a Public Utility is so to relax the rigour of the rules of rating, as to develop backward areas, strengthen nascent industries and afford relief to tracts starved in particular Utilities. The differential treatment required in such cases cannot be left to the discretion of private corporations. The Railway Rates Advisory Committee, which was created in 1926 to deal with complaints of discrimination, has proved ineffective. The logical course is to place all Indian railways under State management and administer them as Public Utilities. Nationalisation and centralisation are called for in undertakings whose actions affect the entire community, and extend to the distant future.

In regard to the Post Office, which is an out-and-out Public Utility, a vindication of its true nature should have secured many useful extensions of its activity, which are still lacking. We may consider some

instances: (1) The declared purpose of the Postal Savings Bank is to develop the habit of saving. To protect the thrifty housewife from the improvidence of her husband, her savings in the Post Office are brought within the Married Women's Property Act, and her dealings with the Savings Bank are protected by special rules enforcing secrecy on the part of the Postal officials. The State obtains the use of considerable sums of money through its Savings Banks, but the rate of interest it offers to the investor in the Savings Bank is lower than what it pays on its public loans. Savings Banks deposits are not *all* call-money. Even if they were, the reserves of the Government and the efficiency of its Resource operations should be sufficient to guard it against any run on the Savings Banks, such as that which occurred during the early period of the War. (2) In the undeveloped condition of banking in India, the Indian Post Office has exceptional facilities for undertaking banking functions. The Government has a duty in the interests of trade to provide facilities for cheap remittance of money. It has in the Post Office an exceedingly convenient agency for the work, superior to those of most of private banks. Nevertheless the 'money-order' rates now charged by the Post Office are unjustifiably high. (3) The Parcel Post offers scope for improvement on the lines of European services. At present, its methods in India are crude, conservative and uneconomical. Its use is naturally restricted. Such instances illustrate the line of improvement which would come, if these great undertakings are treated as Public Utilities, and the manner in which such improvements will react favourably on the economic condition of the people generally and of the financial resources of the Government.

Retrenchment in Public Utility Undertakings.

In the careful survey of the scope for retrenchments, which Administrations in India have been undertaking, motives of business efficiency have had less influence than their own financial difficulties. These have been concerned with the Commercial and Public Utility departments. Railway Committees have dealt with the question of the opening of competing lines and of the futility of opening unproductive lines. The Jayakar Committee has dealt with 'road and rail' competition. Mr. B. A. Pope's Committee has inaugurated a useful system of 'job analysis'—a kind of efficiency audit—and by its means, the Committee claims to have effected, by June 1934, in a single railway, a reduction of a third of the establishment charges, amounting to the large sum of 43·27 lakhs. The Committee has called attention to parallel organisations side by side and the waste resulting from the absence of a system for the pooling of rolling stock and locomotives. In four railways, as many as 600 locomotive engines were found "stabled". The extension of such operations will discover further avenues for economy in the working costs of railways.

The State and Railways.

Hesitation still characterises the attitude of some Indian public men towards the State's relation to the railways. There is a disposition to deprecate the extension of State activity, and to rely more on State control, rather than on Government management and ownership. Those who hold this view, miss the lesson of the history of Public Utilities, throughout the world. It shows that in their early stages, Public Utilities need State subsidy and encouragement, later on they obtain total or partial exemption from taxation, and in

their full maturity of development they come under the taxing scheme. "Public Utilities are now used everywhere as indirect tax-collectors."[1] Motor and omnibus services, urban tramways, municipal lighting, heating and power supplies (by gas and electricity), and municipal water-supply and sewage disposal, are other kinds of public utilities which are not yet "nationalised". But some of them are owned and administered by public bodies like municipalities, and the others are controlled.

Irrigation.

Irrigation works appear to lie in the penumbral region of Public Utility. This is mainly due to their having been constructed entirely by State agency, through a mixture of fiscal and humane motives. They figure conspicuously in Indian life and finance.[2]

On the assumption that the State in India is the ultimate proprietor of all land, our great Irrigation works have sometimes been viewed as merely improvements effected by a wise landlord with an eye to the enhancement of his future rents. This view is incorrect. Irrigation works are really Public Utilities. They have the element of monopoly, and are provided in areas where competing sources of water-supply are either absent or are hopelessly inadequate. The statu-

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[1] Martin G. Glaeser, *Public Utility Economics,* 1931, p. 585.

[2] The total irrigated area, from Government sources in British India is about 30 million acres (31·6 millions in 1929-30 and 29·6 millions in 1931-32), the total capital outlay about 142·6 crores, the gross and net revenues 11·5 and 7·1 crores, their working expenses being over 4 crores. The net return on capital (including huge Schemes like Mettur and Sukkur projects, which have not yet begun to yield revenue) is over 5 per cent. on the capital outlay. In the Punjab the return from capital spent was 13 per cent., in Madras 6·16 per cent. and in the United Provinces 4·6 per cent. The figures are for 1932-33. That year a Central Bureau of Irrigation was established as an essential adjunct of the Central Board of Irrigation. They are both financed by Central and Provincial contributions.

tory right of the Government in India to the ownership of all water, standing and running, and to charge a price for it, does not alter the conclusion. Without proper irrigation works, the water will not have any economic value at all and the Government will not be able to obtain a water-rate. In a tropical area, water is vital for cultivation. If it is supplied by a public irrigation work, on what principle should the rating for its supply be made? In the case of perennial rivers, whose water is carried to the fields through ancient water channels, the Government incurs little or no cost. It is otherwise in big irrigation schemes, whose cost varies with their nature and the character of the land through which the distributory channels are carried. A barren and sparsely peopled area may also be one in which canal extension is costly. The area must be peopled and cultivated, before it can be taxed. If the water-rate for the area, in the initial years at least, is based on the cost of providing and administering the scheme, the area will continue unoccupied. Beyond this area, there may be a tract in which the supply of water will be immediately remunerative owing to the greater fertility of the land, density of population, and accessibility to markets. The water-supply to the two areas must be at different rates. There are similar difficulties in the way of fixing a uniform rate for water supplied to cultivation from Government irrigation sources. The apparently equitable principle of proportioning the rate to the benefit received may, if applied uniformly, work hard in the case of lands which are being reclaimed mainly by the facilities provided by the new irrigation works, and more so in the case of lands, which are occupied but will reach the margin of cultivation only with free water. A plausible case has been made out for maintaining a *uniform rate*. It appears equitable,

and to simplify assessment and collection. But, it does press more heavily on some areas than on others, and prevents the extension of cultivation and the full utilisation of the benefits of an irrigation project. Accordingly, the principle of a uniform rate is not accepted, in spite of the support which it has received from some economists and administrators.[1] The linking of irrigation works, and the separation of irrigation finance will still further improve their administration as Public Utilities, and lead to a more correct perception of the economic principles on which their services should be assessed.

Other Utilities.

The supply of gas and electricity, and the provision of omnibus services and tramways are generally made by private corporations, under a system of controlled rates. They are usually not taxed except as regards their net income even in States, which levy a franchise tax on Corporations. Their services grow with the increase of population and urbanisation. A tax on such Utilities will be productive and elastic. The tendency of our day is therefore to tax such Corporations, while leaving free those under State or Municipal management. It is not easy to find a simple rule on which they can be equitably taxed. If they are taxed according to their value as 'going concerns', it will cut into 'Corporation' earnings, deter further private investment in Utilities, and increase the cost to the consumer. If Public Utilities are untaxed, unequal tax-burdens will be laid on consumers and non-consumers, as well as on different classes of consumers. Such taxation of Public Utilities, as is imposed, will, except

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[1] See Gyan Chand, *Fiscal Reconstruction in India*, 1929, pp. 135-137.

in the case of big hydro-electric schemes, be local. India is very backward in the provision of Power-generating concerns, which are vital to her economic development. It will be therefore necessary to tax such concerns lightly, in spite of their being monopolised, till their number becomes adequate to the country's requirements. Tramways, which enjoy a virtual monopoly, but whose rates are fixed by the State, will be unable to shift their tax-burdens on to the consumer, unless the rates charged are lower than the true monopoly rates.

The Public Utility services will prove a steadily growing source of income in India. Irrigation works now more than pay their way. Already they yield some profit over and above the increase in revenue they have secured by the extension of cultivation. So was it with railways also. In regard to the Post Office, the social value of its services will justify a discrimination between different kinds of service, as between the post-card and insurance, and of re-adjustment of rates to increase its popularity among the poorer classes. The present average of four communications per head of the population for a year is very low. An increase of postal rates has to be viewed as a tax on both education and commerce, and it should accordingly be unwelcome in India, in spite of the additional revenue it may bring.

Administrative Economy.

The scope for economy in the administrative services more readily attracts attention. Three-fourths of the expenditure on the Public Services is now outside the purview of the Legislature. This cannot make for the economy, to be ensured by 'parliamentary' criticism. In a democracy, the Legislature is the watch-dog of finance. One feature of Indian adminis-

tration tends against its economical working. It consists in the tradition and influence of the higher services. They have developed an *esprit de corps* and an aptitude for conjoint action on Union lines. The economies in the services, which have been so far attempted, come under two classes. Firstly, reductions have been suggested in the number of appointments and their aggregate emoluments. Secondly, the substitution of Indian for British agency has been pressed. Most of the services (with the conspicuous exception of the Army, the Indian Civil Service and the Indian Police) are now provincialised and are more amenable to Indianisation. In the 'reserved' services, a discrimination based on the place of recruiting is in sight. The Indians in these services have become as reluctant as the British members to surrender their special advantages.

The grounds for the 'special protection' of the 'security' services are that a minimum British element is essential to the safety and progress of India, and that the terms offered to public servants should remain at a level which would ensure a continuous supply of officers of the right type. Salary standards at the top are not now well related to either the nature of the work to be done or the ability of the employer to pay. The economic unsoundness of the principles weakens their political justification.

'Congress' Scheme of Salaries.

The unpractical suggestion, which has come from the left wing of Indian Nationalism, for fixing merely nominal salaries, with a maximum of Rs. 500 for the highest offices in India, is the product of a confusion between sentiment and economic considerations. As the Government of India becomes democratized, the permanent services will have to be strengthened, as they

will have to stand the impact of the forces of Party and Faction. An under-paid and inefficient service will not stand the strain, particularly in the transitional period. Provincial autonomy, with elected ministers in executive posts, will necessitate strong Secretariats to make up for the inexperience of ministers. The Services will continue to do the entire routine administration. The overworking of the Legislature will intensify the tendency to the enlargement of the authority of the executive by the grant of Rule-making powers to it. This 'New Despotism' (to use Lord Hewart's expression) is already potent in India. It will become more influential, when full autonomy is gained. For a considerable time, the political power in India will be in the hands of a small part of the population, and be subject to communal cleavages. India must therefore do nothing, even in the interests of economy, which will weaken the strength, efficiency and integrity of her public servants. When democratic institutions get stabilised, it will be necessary to review periodically the scope for reductions in her administrative expenditure, for the substitution of honorary workers for salaried ones, and for revisions in pay-scales in harmony with the ruling prices in the labour market. The opportunity should be utilised to correct the action of the tendency of democracy to increase beyond necessity the number of low-paid appointments, and thereby swell the service-cost, while retrenching the higher appointments. It is undeniable that not unoften envy sharpens the passion for equality in the attacks on salary standards.[1] Indiscriminate retrenchment often increases expenditure, as for example, by premature retirement of experienced and physically capable officers, and by the

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[1] See Lord Bryce's *Modern Democracy, passim,* for illustrations.

abolition of essential offices. This should be guarded against. Equally important is the need to guard against non-economic motives in the recruitment of the public services. The May Committee in Great Britain (1931) found that the cost of administration had been increased by the preference given to ex-service men.[1] The Committee characterised the policy as a violation of 'the principle of selection by competence'.[2] This has a lesson for India. While the Commercial departments in India have conducted enquiries into their working costs, no attempt has been made to determine them for the administrative departments. The percentage which the cost of collection bears to gross revenue is 12 to 13·1 in India, *i.e.,* three to four times what it is in the United Kingdom. Such a comparison misses however the mixture of fiscal and administrative functions in the hands of the Indian executive. While, on the one hand, this combination of duties appears on the surface to be economical and to promote efficiency in the collection of revenue (which requires intimate knowledge of the locality and the people, *e.g.,* Land revenue) it makes, on the other hand, cost-accounting almost impossible. The experience of Income-tax administration through the Central Board of Revenue at Simla has proved that it will not be difficult for a staff like that of the present Income-tax Service to assess the income from land also, with an efficiency not lower than of the present district officers.[3] If this claim is justified, there will be

[1] "We do not think it is generally appreciated how many restrictions hinder the free working of the Civil Service machine. Ex-service men receive preferential treatment—a policy which departs from the former policy of selection solely by competence" (para. 48, p. 23). On communal recruitment to the public services in India, *see* Sir M. Visvesvaraya, *Planned Economy for India,* 1934, pp. 229-230.

[2] *Report of the (May) Committee on National Expenditure,* para. 48.

[3] In his evidence before the Indian Taxation Enquiry Committee (see *Report,* p. 215) the Madras Income-tax Commissioner asserted:

openings for economy in the working costs of district administration.

Retrenchment.

The general principles of retrenchment in the civil services are laid down in the Report of the May Committee. The substitution of honorary for paid workers in offices involving light duties, and bringing up the pay of Government employees, to the level of the salary standards in private services, after due consideration of the differences in prestige, security and pensionability, are among the Committee's suggestions.[1] The May Committee did not recommend reductions solely by reference to lowered cost of living. Other elements besides cost of living, such as the expenditure involved by family and social position, have to be allowed for.[2] Scarcity allowances were given in India to the lower grade of public servants for the high cost of living, and overseas allowances are still paid to the higher officers recruited in England.

A demand for the reduction of Government pay rolls springs up in periods of falling prices and reduced public activities. It is usually met by arbitrary reductions, effected by a rule of thumb. A flat percentage 'cut' is usually applied, *e.g.*, Germany in 1929 and the U.S.A. in 1933 adopted a 15 per cent. cut. Great Britain and France have preferred graduated scales of reduction to meet the principle of 'equality of sacrifice'. The British 'cut' in 1931 ranged from 10 to 21 per cent., and the French 'cut' from 2 to 8 per cent. India has done

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"After two or three years our list of assessees of agricultural incomes would be as accurate as our list of business assessees."

[1] It may be asked whether prestige does not depend to some extent on status and pay.

[2] *Report of the May Committee*, p. 52.

so too. No Government has yet devised a systematic and workable plan for the correct adjustment of salaries to falling prices.

Tax Exemptions.

The question of abolishing Tax Exemptions is allied to that of retrenchment. Exemptions from the land-tax are now enjoyed by holders of Inam lands, Jahgirs, the estates of temples and mosques, as well as of lands assigned for village service. The conversion of 'Service Inams' into salaries will bring to the State the incremental growth in value of the land recovered. The grant of tax-free lands to temples and charitable endowments is a continuation of the pious attitude of the past, and it survives in modern British practice. It is in conformity with the principle that a Government should ordinarily be bound by the grants, acts and pledges of its predecessors. But, it can be argued that they form a public subsidy to religious denominations, in spite of the Government's neutrality. In the old Hindu State even the residences of schoolmasters were exempted. The grant of desultory concessions is uneconomic. Open subsidies are preferable to concealed.

Tax exemptions are claimed and granted in less advanced communities chiefly as marks of distinction or independence. Among the dozen classes of exemption, which modern fiscal practice encounters, the *economically* valid cases are three. They are those designed for the avoidance of (1) double taxation by the exemption of a person who is already reached by other branches of taxation, (2) the purposeless transfer of public funds, as by exempting the taxation of the State itself and its agencies, (3) and the trouble and expense of collection out of all proportion to the income likely to accrue.

The exemption of certain kinds of public securities from the Income-tax will not come under these categories. It is virtually a concealment of the real cost of the loans, as is the extension of the principle of exemption to Disability and War pensions. The former impairs the progressive-rate feature of the Income-tax and makes such securities specially welcome to persons whose income will suffer from progressive taxation. It also sins against the canon of equality. But, it may be defensible in the case of bonds mainly held by alien holders, since it will afford them a guarantee against discriminatory taxation started by the borrowing State as a means of escaping the burden of interest charges.[1]

The exemption from Income-tax of Government securities held by the Provident Funds, to which the Provident Funds Act of 1887 applies, aims at encouraging saving. It is thus a disguised bounty. The exemption of the holdings of the Indian Debt by the Indian States is indefensible, and rests on a confusion of their position as 'Sovereign' States and as mere investors. A searching enquiry into the character, grounds and financial effects of all existing exemptions from taxation in India is needed in the interests of both economy and proper accounting.

Monopolies—Opium, Salt.

Public Utilities do not exhaust the resources of India on the 'non-tax' side of public revenue. Fiscal monopolies have been used extensively to support tax-income. The tobacco monopoly in France is a great financial asset, and is utilised for her scheme of amortization of the Public Debt. Spirits are a lucrative monopoly in Germany and Finland. In the budgets of Poland

[1] *Cf.* M. Gaston Jeze in *Encyclopaedia of Social Sciences,* XII, 1934, p. 604.

and Austria to-day the proportion of income from monopolies to the aggregate revenue ranges from one-fourth to one-fifth. In India, the only 'monopoly' in the strict sense is Opium, the revenue from which is approaching a point at which it will vanish.

Salt is virtually though not technically a monopoly. The salt tax is the sore spot of Indian Finance. It is attacked on the grounds that it is degressive, that it weighs most on the poorest, that it taxes a vital necessity of life and health, and that other taxes on consumption touch also those who pay the salt tax.[1] Owing to its place in the scheme of domestic consumption, it used to be alleged that it cannot show *much* response to price-changes, but it has been found that its consumption *is* affected by variations in rate of the tax. In 1882, its consumption stood out 28·3 million maunds, and in 1887, when the tax was lowered 20 per cent., the consumption rose to 33 million maunds, and it decreased by 2 million maunds, when in 1888 the tax was again raised. It is alleged, though without convincing proof, that an increase in the salt tax undermines the health of the poor. In spite of its unpopularity (which its supporters attribute to the agitator) it is continued mainly on the grounds that it is a light burden, which accounts only for a low proportion of the income of the wage earner, that it is widely distributed, and that it can be raised or lowered according to budgetary needs. But, frequent changes in the rate of a tax which falls on the

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[1] "For two-thirds of the human race, Salt is still the first of luxuries. It is a luxury in the sense that it is not physiologically necessary. Salt has manifold uses as accompaniment for food, as a preservative, as medicine, as manure, and as the raw material in several industries. It is obviously a first class object of taxation, and has been for centuries taxed in most countries. It was long taxed in England and caused great trouble, internal and external, and was repealed in 1825." (E. Hughes, *Studies in Administration and Finance,* 1558-1825, 1934.)

masses have an unsettling effect on the popular mind. The facility with which it can be lowered or raised is claimed as its economic merit, while it is an apparent political defect. The salt tax is easily the most unpopular tax in India.[1] Its repeal will be popular, though it will upset the financial equilibrium. When recently it was desired to challenge the authority of the Government, in such a way as to hold out an appeal to the mass mind, the infringement of the salt monopoly was selected for the purpose.

The salt tax raises questions of the fiscal relations between British India and the Indian States. Some of the States produce salt and supply it under stipulated conditions to the British Government. Others depend on imported salt. The incidence of the salt tax is not the same in both these cases. Foreign salt is preferred in Bengal.[2] Its importation diminishes the income from the salt manufacture in India. Before it can be checked, the Bengal consumers' taste must be educated to appreciate Indian salt. A discriminating duty on the imported salt, which will render it slightly more costly than Indian salt, has been suggested on the ground that if the Bengal consumer prefers the foreign article, he must pay for his preference. But, on political grounds the application of the principle of discrimination to an article like salt is inadvisable.

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[1] The rhetorical condemnation of the Salt tax by Lord Curzon has helped the agitation. He said: "What is the tax that touches all classes down to the humblest? It is the Salt tax. . . . Who are the people of whom I speak? They are the patient humble millions, toiling at the well and the plough, knowing little of budgets, but painfully aware of the narrow margin between sufficiency and indulgence. It is to them my heart goes out. They are the real backbone of our economic prosperity."

[2] We manufacture excellent salt, as good as the best foreign salt, near Oka in Kathiawar.

Forests.

The Domain in India consists of unoccupied land and forests. Some of the former is taken up, and brings in a substantial but non-recurring income, when irrigation facilities are extended to waterless tracts. But, the income from such sales must not be treated as ordinary revenue, and when derived from the opening of new irrigation works, it should be added as capital to the sinking funds set up for such works.

The revenue from the forests will not expand much unless more is spent on conservation, plantation, protection and communications than is now done. The additional expenditure is well worth incurring. But, where the administration of forests has become a provincial subject, there has been a marked tendency to weaken forest policy and to sacrifice future interests, which lie in vigorous conservation and improvement, with a view to silencing popular clamour.

Tribute.

The tribute from Indian States brings in a small revenue of about three-quarters of a crore. The amounts paid vary, and do not always correspond to the resources of the States. One State pays as little as Rs. 3 and another as much as Rs. 24·5 lakhs of rupees. Sentiment more than financial gain is behind the demand of the Indian Princes for the abolition of the tribute. In Mysore, the tribute is also viewed as an unduly heavy burden. In 1931, Lord Sankey was inclined to remit the tributes but considered it impracticable in view of the financial condition of India.[1] Its abolition may be agreed to only when it is made a set-off for something

[1] *Proceedings of the Indian Round Table Conference,* Second session, II, p. 1291, and p. 1306.

conceded by the Indian States. The Davidson Committee recommended the grant of a credit to individual States amounting in the aggregate to a crore of rupees.[1]

Stamps and Registration.

British India as well as most Indian States derive a steadily growing income from stamps and registration. The latter has the element of a *fee* in it. But, as the amount charged exceeds the value of the benefit conferred on the payer, it has to be treated also as a tax. Fees tend to harden into taxes. A growth of this revenue is sometimes welcomed as an indication of improving economic conditions, and at other times condemned as a sign of increasing litigiousness. The increase in *revenue* stamps is an index of prosperity. The opinion of Sir Henry Maine (1869) that the tendency of litigation should not be encouraged by any lowering of Court-fees is supported by many present-day lawyers, who apprehend an increase in the number of undesirable persons to whom litigation is a luxury and a pastime. An increase in civil litigation is unavoidable, as the masses grow in self-respect and in knowledge of their rights. Reluctance to put up with injustice is not bad in itself even if it drives a person to a court of law to secure redress.[2] In this view, there is force in the plea of Bentham that no State should make a profit by dispensing justice. On the other hand, the courts of law are frequently asked to correct the negligence and foolishness of private parties, to collect private debts, to secure the specific performance of contracts, and to do such economic services as winding up

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[1] *Report of the Indian States Enquiry Committee (Financial)*, 1932, para. 446 (p. 155). When this set-off is considered, the fact that Indian States are now sharing the income of the Road Development Fund, should not be forgotten.

[2] The jurist von Ihering acclaimed it as a necessary civic virtue.

a company or a bankrupt estate. It is manifestly reasonable that the general tax-payer should not be burdened in such cases, and that the Government might even earn some profit, through the law courts which discharge such duties.[1]

Tax Resources.

There remain the great props of the Indian Exchequer, the so-called 'Direct' and 'Indirect' taxes.[2] The complexity of modern economic organisation makes the distinction between 'direct' and 'indirect' taxation difficult to draw. Mill laid emphasis on legislative intention and purpose as their distinguishing marks. The intentions of legislatures are frequently defeated when tax schemes, which they sanction, are put into operation. The modern tendency is to prefer other distinctions, but the old classification continues in use.[3] The experience of India is different from that of the West in regard to the historical relation of 'direct' and 'indirect' taxation. The ancient Indian State used both, but relied more on 'direct' taxation (in the form of the land-tax) than on Customs. It depended also much more than the State to-day, on the income from the Domain and Monopoly. The modern drift carries us back to the practice of ancient Indian Finance. In India 'direct' taxation has not been the *last* step in the

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[1] *Indian Taxation Enquiry Committee's Report,* pp. 246-247.

[2] The classification is not scientific. It attempts to differentiate between the tax-payer and the tax-bearer, and holds that in 'direct' taxation, one and the same person is both. J. S. Mill's criterion, though slightly more objective than that of Adam Smith (who borrowed the idea from the Physiocrats) is not useful, as it is based on the intention of the legislature, which may or may not have existed, and is at any rate a difficult thing to discover.

[3] Taxes can be classified according to base, media of payment, regularity of levy, purpose, jurisdiction, manner of tacking the charge, legal basis, imputed economic source, stages of economic processes affected, nature of the rate-structure, and assumption regarding shifting.

evolution of public revenue, as it has been in the West. Even the Income-tax was made a stable feature of the Indian fiscal system, before it was done in the West. The use of a mixture of 'direct' and 'indirect' taxation, along with Monopolies and Public undertakings, as additional supports, is now the ideal of an elastic fiscal system. This ideal was developed in ancient India, as it has been in the modern, by the force of circumstances. Academic valuation of particular taxes or generally of 'direct' or 'indirect' taxation is now out of fashion, as the fiscal system is to be considered not in parts, but as a whole. Judged in this way, the experience of no country is found to agree with that of another as regards the effects of the same type of tax-burden. For instance the Colwyn Committee noticed that in Great Britain 'direct' taxation (consisting mainly of Income and Inheritance taxes) was less crushing than it was supposed to be.[1] The experience of 'direct' taxation in India in the form of the Land-tax is different. It is now a heavy and unequal burden. The pressure of Indian taxation falls heavily on the unaffluent classes, which are made to bear the weight of both 'direct' and 'indirect' taxation. With the spread of Socialist ideas, the tendency in the West is to condemn 'indirect' taxation, and regard 'direct' taxes as the financial reserve. In India, the official, and even non-official, attitude is just the opposite.

The Land-tax.

It is not possible to deal with more than a few relevant aspects of Indian Land-revenue. It has long dominated the Indian financial system, but before the British conquest, Burma had no land-tax. It is collected under

[1] "The burden of direct taxation is less crushing than is frequently represented." (*Report of the Committee on National Debt and Taxation*, 1927, p. 245, para. 702.)

varying systems of assessment, in areas in which it is not fixed on a permanent basis. Its true character, which has a direct relevance in the determination of the rates, has been obscured by the assumed relation of the State to the land. The old theory that the land-revenue in India is to be regarded either as an economic rent, or a tax upon economic rent, and not a tax, is now generally abandoned. The Indian Taxation Enquiry Committee (1926) treated India's land-revenue frankly as a tax, and so do most modern writers. The Indian land-tax involves a compulsory transfer of income from the landholders to the State. Considered as a tax, its rating appears unduly high. But, with the high percentages of income, commandeered by taxation in modern times, the comparatively high proportion of the yield of land taken by our Government as land-tax will fail to raise any emotion. The right of the Government to land-revenue, as to any other tax, is incontrovertible. Its continuance can however obtain academic support only if it is shown to be not inimical to the welfare of the country. It affects eighty per cent. of our population, and is supposed to be enshrined in Indian history and tradition. Dispassionately viewed, the main responsibility cannot be laid, as it has been sought to be done,[1] on the land-tax for the poverty, lack of enterprise, famines, rural debt and economic stagnation. The root causes of these evils are to be found elsewhere. But, the method of the administration and assessment of the Indian land-tax, and the inequalities which have grown round it, have accentuated existing disabilities.[2] It is even now the most important source of public income next to Customs, as it brings in Rs. 34 crores a

[1] Vera Anstey, *Economic Development of India*, 1929, p. 375.

[2] *Cf.* for example the economic writings of R. C. Dutt, and particularly his "Open Letters to Lord Curzon on Famines and Land Assessments in India," 1900, *passim*.

year. It is the chief Provincial source of revenue. In any future scheme of fiscal reform, before the Provinces can be made to surrender the land-tax, they must have the assurance of an adequate substitute. Some of the principles of resettlement, like basing enhancement on changes in prices and improved environment, have tended to confuse the tax with rent. Some economists have tried to get round the difficulty by classing it as a tax on property and not as one on the income from land. Dr. Marshall's conception of the land-tax as the share of the State, regarded as a sleeping-partner, will explain enhancements in re-settlement, the absence of a minimum of taxable exemption in the case of the land-tax, and the help to cultivation given directly and indirectly by the Government, but the application of this principle to the Indian land-revenue will *not* give it a unique character, as the State is now viewed as a sleeping partner in *all* economic activity.

The Indian land-tax system is full of anomalies. Considered in relation to the area, the tax varies to the extent of 280 per cent. between provinces and province, and 300 per cent. to 400 per cent. if viewed in relation to the provincial population.[1] Its method of assessment in different provinces diverges widely. Its proportion to rent ranges from 50 to 20 per cent. in the United Provinces, 42 to 7 per cent. in the Central Provinces and 100 to 10 per cent. in Madras. It is growing in rigidity. Far from being progressive in character, it is actually degressive. The recommendation of the Joint Parliamentary Committee in 1919, that the taxation of land should rest on legislative and not mere executive sanction, will, if accepted, make land-revenue the plaything of our Party politics in the future. The maintenance

[1] C. N. Vakil, *Financial Developments in British India*, 1926, p. 371.

of a reserved area under Permanent Settlement, which intercepts in perpetuity the "incremental gains which should accrue to the community", makes its retention in our scheme a challenge to fiscal justice. It is easy to sum up its shortcomings. "It is uncertain in incidence, inconvenient in assessment and collection, uneconomical in its administration, unequal in its distribution, and inelastic, and far from benefiting the cultivator, who pays the tax, it is prejudicial to the growth of capital and the improvements to agriculture."[1]

It is the Permanent Settlement which makes the retention of land-tax impossible in a modern fiscal system. Even if the revenue paid by the permanently settled estates is viewed,[2] as a fixed annual commutation, or as the purchase price for the absolute ownership of the Zamindari land, it only adds point to the demand for the taxation of the rent of the Zamindars. The Taxation Enquiry Committee declared that the authors of the Permanent Settlement had given no pledge which might debar future taxation of agricultural income. Even if it were otherwise, in periods when the warmth of socio-economic feeling is softening the angularities of contracts, the continuance in perpetuity of a promise operating against public interests, will become increasingly difficult, with the steady democratization of the Government.

The Income-tax.

Seventy-four years have passed since James Wilson introduced the Income-tax in India. For nearly a generation, it continued to be regarded merely as an

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[1] N. S. Narasimha Aiyangar, in the *Indian Journal of Economics,* VII (1927), p. 147.

[2] V. K. R. V. Rao, *Taxation of Income in India,* pp. 96-97, and "Income Tax Cases", pp. 74-75.

experiment. The fear of an anticipated deficit of 20 crores in 1886 compelled the passing of an Income-tax Act that year. Its scope was originally very extensive. The Act of 1886 based the right of tax incomes on both origin and residence. But, the assessment was arbitrary and incidence unequal. It did not distinguish between the character of the income, *i.e.,* whether it was permanent or temporary, earned or unearned. The yield however steadily increased; and the demand for additional revenue prompted the introduction of progressive rates in 1916, and of an improved administrative machinery in 1918. Further legislation led to a consolidating Act in 1922, which is now in force. It has brought the Indian Income-tax nearer modern theory and practice.[1]

To-day the Income-tax is an accepted feature of the Indian financial system as it is the backbone of British finance. It is amusing to read the violent condemnation of the Income-tax in the Indian Legislatures thirty years ago side by side with the praise it now receives, without going so far as a recent writer who compares its benefits to those springing from the introduction of the English language in India, and classes them together as instances of the happy heritage of British rule in this country.[2]

The outlines of the Income-tax system of India are fairly clear. The tax is on the *net* annual income accruing or received in British India, which exceeds the prescribed minimum which stood at Rs. 2,000 till November 1931, when it was lowered to Rs. 1,000. It

[1] The Government of India have invited two officers of the British Inland Revenue department to enquire into Indian Income-tax law with a view to remove anomalies and place it on a scientific basis (May, 1935).

[2] V. K. R. V. Rao, *Taxation of Income in India,* 1931, p. 43. The eulogy overlooks the existence of a kind of income-tax in India even in pre-British times.

is collected partly at source and partly by direct assessment. The agency for the collection is also the final authority on findings of fact, while on points of law an appeal is allowed to the local High Court. The machinery of collection is entirely official. The Super-tax is really an additional rate of income-tax on assessees, whose income exceeds Rs. 50,000 as individuals, and Rs. 75,000 as members of a joint-Hindu-family. Tax-free securities are exempt from Income-tax but not from the Super-tax. Capital gains and casual income are exempt. Incomes accruing abroad to Indians is not taxable. Non-residents are taxable on their Indian income. The governing principle is origin, and residence does not create liability. Agricultural income, as defined in Sections 1 (1) and 4 (3 sub 8) of the Income-tax Act of 1922, is exempt. The other exemptions include the property of religious and charitable institutions, interest on Government securities held as the property of their States by Indian Princes, the securities of the Mysore Darbar, gratuities paid to railway servants, pensions, salaries and leave allowances of Indian employees paid in Great Britain, the interest on Post Office Savings Bank deposits and cash certificates, and certain Provident Fund securities, and Life Insurance premia up to a sixth of the income. The rates are graduated so as to be steeper on the higher incomes, but there is no discrimination between 'earned' and 'unearned' income. Corporations are taxed at the maximum rate of 18 pies for Income-tax, and at a lower flat rate for the Super-tax. The profits of shipping companies incorporated outside India are free. With the exception of certain concessions granted to soldiers, no special consideration is shown to any section of the community.[1]

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[1] In Italy officials are taxed at a lower rate than others. See Robinson, *Public Finance*, p. 54.

The effects of the Income-tax on the economic condition of India during the last forty years are not easy to estimate correctly. The necessary statistical material is lacking. But, a rough examination shows certain aspects of the economic conditions as revealed by the Income-tax reports. The number of Income-tax assessees is small and has shown little increase. This may indicate that there are very few well-to-do persons in India. The income per head among assessees shows a decrease. In the lowest and highest grades there is virtually no proportionate increase, but in intermediate grades an increase both absolutely and relatively to the total number of assessees is noticeable. It may imply a better distribution of wealth. The industrial progress of the country is seen to be slow, and much disparity in the assessable incomes in different Provinces is apparent.

From the fiscal and administrative standpoints, many improvements in the Income-tax system are seen to be necessary.[1] The scheme of exemptions requires revision. The scope of the tax must be re-defined so as to comprehend both residence and origin. It will stop much leakage of revenue. The "jumps" at points of graduations of rates still hit hard the persons on the margin, in spite of the partial relief provided by the Act. The tax takes no account of the way in which an income is derived or spent. There is no allowance for family or dependents.

The omission of this wholesale provision was explained by the Taxation Enquiry Committee as a set-off

[1] The machinery of assessment in India is capable of improvement. The tendency is to widen the margin with the widening of the conception of living expenses from bare to decent life. The exemptions are widest in Great Britain, in which dependent female relatives, house-keepers and the like are included, and allowance is made for the cost of educating children. In Germany medical treatment and maternity expenses are exempted.

for the low pitch of the exemption margin of Rs. 1,999[1] This is questioned by a recent writer, who has suggested that a deduction must be made at the rate of Rs. 250 for each child subject to a maximum for six children, conditionally on the children being put to school![2] The exemption of religious and charitable institutions, without the safeguards of audit, of proved necessity and of proper utilisation, may be open to criticism, though the necessary inquiries will lead the tax collectors too far afield. The protection of pensions and leave allowances accruing in, but paid outside, India is entirely unjustifiable.[3] The existing agreement with Great Britain, to avoid Double-taxation is not advantageous to India, as the number of Indians with a British income is small in comparison with British owners of Indian income. Sir Walter Layton[4] has rightly held that there is much scope for making the rate of progression steeper, and that the present exemption of the income from foreign investments not brought into India, acts as a positive inducement to take Indian capital abroad. The treatment of Corporation profits now leads to some inequality and evasion. The failure in the present law to provide for suitable allowances on account of depreciation, obsolescence of plant, buildings and machinery, and for the gains of a year being set-off against the losses of the preceding year, is hard on industry and business.

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1 This argument will not now apply as from 1931, the exemption limit is Rs. 999.

2 V. K. R. V. Rao, *Taxation of Income in India*, p. 270. See also *Encyclopaedia of Social Sciences*, VII, 1933, p. 634. Such a liberal exemption would appear to be an incitement to bring up large families, at a time when birth control is widely advocated. It will be defensible only in a country ravaged by a recent war.

3 The exemption is nevertheless guaranteed in the new India Act.

4 Simon Commission's *Report*, II, p. 239.

Following the British practice, casual or non-recurring income, accruing otherwise than in the course of business, is exempted under the Indian Income-tax law. Recurrence and regularity are by implication the criteria of tax liability. In Great Britain, the exemption is justifiable, because there are other provisions to capture wind-falls and inheritances. It is not so in India. The modern trend is against exempting even fortuitous additions to income.

Indirect Taxation.

Indirect taxation is now the sheet anchor of the Indian Financier. The principle of 'taxation for revenue only' is now discarded. India has definitely moved towards Protection. The Ottawa Agreement has however reduced the freedom of the Finance Minister to alter the Indian Tariff. Protectionist bias has resulted in an increase of the rates in Customs. The Indian consumer is now paying for Protection within India as well as within the Empire.[1] In contrast with foreign tariffs, the Indian tariff is relatively simple, consisting of far fewer classified heads. Imperial Preference is making it necessary to revise and enlarge the list. A permanent organisation like the Tariff Commission in the United States of America, but unlike it, in being independent of political influence, is necessary in India. The scope and the constitution of the existing Tariff Board require modification.

Customs.

Import duties have been hateful to Liberal finance. Dr. Marshall would not have them except for purposes of revenue. His contention is that by trenching upon

[1] Owing to the Ottawa Agreement.

the resources of the consumer, they lessen production and the amount of employment at good wages.[1]

The chief export duties in India have been those on jute, raw and manufactured, hides and skins. That on hides was abolished, as its effect was found to be prejudicial to the country. In the absence of other types of containers, jute has become a paramount need of packing. It is not only an Indian monopoly, but within India it is virtually the monopoly of a single province. The demand for jute has created both an agricultural and an industrial interest in its cultivation and manufacture. The income from the jute export duty is now substantial. But, it is not always correct to say that the export duty is paid by the foreign consumer. The price will react on the demand and indirectly press on the cultivation. It is not possible to keep idle plant and machinery, or convert jute land to other uses. The growing of any commercial crop produces a technique and a specialised ability which are not equally useful for raising a different crop. Accordingly, any increase in the export duty of raw jute or manufactured jute, which diminishes the demand, with an undiminished output, must tend to shift part of the duty on the producer. The incidence will fall also unequally on the Indian jute mills and on the ryot who cultivates jute. The latter has a monopoly, which the former has not, since raw jute is worked up in Dundee also.[2] This will necessitate a differentiation in rating, which will prevent the Indian mills suffering from competition with the Dundee factories.

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1 A. Marshall, *Official Papers*, p. 419.

2 The rich mill-owner has a better bargaining power than the poor ryot, who grows jute. It is possible for the former to make the most of this difference in strength and staying power, and transfer his losses to the cultivator. There has long been a complaint that a fair price is not always paid by the mills to raw jute.

The powerful industrial interests behind jute have advocated the total abolition of the duty. The province which produces jute demands the entire revenue from the duty. The abolition of the duty will mean a gift to the big capitalists and the landowners of Bengal. The latter are already enjoying an 'unearned increment' due to the Permanent Settlement. It has been contended with some force that the province of Bengal is making good from the jute grown on its permanently settled lands, a revenue to balance the financial loss entailed on the State by the Permanent Settlement.

The items of 'indirect' taxation need more watching in the national interest than those of 'direct' taxation, lest secret or unanticipated protection might arise, leading to unfair discrimination, and lest persons of small means who now pay both the land-tax and the more general customs, be penalised further.[1]

Excise.

Excise revenue, in spite of the agitation for prohibition, must remain because of its productivity and the unwisdom of abolishing it. As it stands, however, the policy of raising prices has had no great influence in diminishing consumption. It has only tended to reduce further the inadequate income of those poor, who now drink.[2] In the national interest, a percentage of the income from Excise might well be utilised, as in Switzerland and recently in Madras, for temperance propaganda. But, the only effective protection against the spread of the drink evil is a rise in the standard of life and of self-respect of the masses.

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[1] As a matter of history, the arguments in favour of a protectionist policy for India, have gained strength from the neglect of this precaution.

[2] "A man will have his drink and his tobacco whatever it costs." (J. A. Hobson, *Wealth and Life*, 1930, p. 330.)

Conclusion.

There is general agreement among Indian economists in regarding the tax resources of India as inadequate and inelastic. Several of them will admit that the limit of taxable capacity has not been reached, and that there is considerable scope for substantial increase of taxation, provided care is taken to guard against its incidence pressing on the already over-taxed elements of the population.[1] It is unwise to build on the hope that the dawn of autonomy will bring in any reduction in the burden. Relief will not come by mere economy. As Lord Milner[2] declared, "mere reduction of expenditure is not necessarily economy; it may be, it often is the most pernicious form of waste". In India financial reform in the future will look for readjustments of the incidence of taxation and the benefits of expenditure in the strengthening of the revenue side, by developing income from non-tax sources as well as by additional and more efficient taxation. There is no dearth of proposals based upon local knowledge, and foreign experience. Their consideration, in relation to the wider question of national development, should form part of a comprehensive survey, which will not ignore the outstanding problems of the impending constitutional changes.

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[1] Sir Walter Layton's *Memorandum*, in the *Simon Commission's Report,* Vol. II, p. 208.

[2] *Questions of the Hour,* p. 131.

V.

Some Outstanding Problems.

Finance and Politics.

Finance is a function of Administration. The two are interdependent. The character of a country's financial system must affect the efficiency and outlook of its administration and be influenced by it. The future of Indian finance is bound up with a number of constitutional problems which are awaiting solution. The examination of the most outstanding of such problems is a necessary preliminary to the preparation of any useful schemes of financial reconstruction. Such a consideration can neither forget the past nor overlook the limitations imposed by existing conditions or be blind to the tendencies and needs of the future. Schemes of reconstruction have to be related to tradition, reality and the trend of evolution.

Autonomy and its Implications.

Among our unsettled questions, *autonomy* stands first, whether we consider its intrinsic importance or the ideals of the day. It dominates the political horizon. It furnishes the logical justification for ideals like Provincial Autonomy and Federation, which seek to reconcile the calls of unity and liberty. It implies more than mere political issues. The relations of India with Great Britain, and, at least since the Ottawa Agreement, with the self-governing Dominions of the Empire, are largely economic in character. The beginnings of Empire are ascribed to motives of commerce and eco-

nomic exploitation of conquered or acquired territories. These aims persist, even when formally disavowed, and continue to mould Imperial policy.

It has been so in regard to the relations between Great Britain and India. Their economic relationship has been part of the political. Political justice has often had to give way to economic interests. We have had policies and measures, which are hard to reconcile with equity, and are defensible only on grounds of expediency. It is possible to perceive economic forces, which are independent of Party, behind the serried ranks of the reactionaries in Great Britain, who oppose an acceleration of the pace of the advance of India to such autonomy as will give her equality (within the Empire) with the great self-governing Dominions, which have been beneficiaries of the Statute of Westminster.[1] An Industrial Democracy often finds it more difficult to enfranchise a dependency than a less liberal type of political organisation. The problem of liberty for India is not unconnected with that of unemployment in Britain. The economic and fiscal freedom, which is necessary to India for her development, is withheld by a fear of its being used to reduce the advantages which British industry and trade now derive from the continuance of the existing order and of the present political arrangements and relations.

If India attains full Dominion Status, she will have the freedom to govern herself, subject to conventions resting on tradition and interest, making for her willing submission to the common purposes of the Empire. The subordination of her interests to those of the Empire should give India a corresponding voice in the

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[1] E. C. S. Wade and G. Godfrey Phillips, *Constitutional Law*, 1933, pp. 365-369 and 369-372 (the present position of the Dominions).

determination of Imperial policy. It must secure Empire citizenship for Indians, who must be free to enter and reside in all parts of the Empire, unobstructed by discriminating laws, stunting their progress and galling to their self-respect. It must place the recruitment of the Government service in India on a natural basis, without any trace of race discrimination. It must show that India is free to organise her defence and to determine the extent and nature of her obligations for it. It should make her responsible for the upkeep of a standard of duty and honour in international relations, commensurate with her history, strength and position. But she will not enjoy more than any other autonomous nation, the freedom to transgress the accepted rules of international conduct.

There has been an apprehension that the grant of full autonomy to India will lead to unhappy economic results, both to Britain and India, and end in a discrimination against the British element in the Indian Government services, in commerce and industry, in repudiation of India's foreign debts, and in legislation coloured, if not inspired, by race prejudice. These fears are largely baseless, and are due to expressions of opinion, which are not those of an independent and responsible Commonwealth, animated by the desire to rise to its proper level in the scale of nations. Nevertheless, the fear exists, and is reflected in the excited demands that Britain should not abdicate its duty to India by evacuation, and in the pressure put on responsible authorities in Great Britain to emphasise the 'safeguards' and tighten the grip over India. The removal of all matters concerning Defence, the Public Debt, Foreign Pensions and the Security Services from the purview of the Indian Legislature, and the maintenance of the present control of Whitehall over Indian affairs,

in the name of Parliamentary Sovereignty, are manifestly due to this fear. On the other hand, it has led to the closing up of the ranks of Indian parties in a united opposition to such reaction. It is right, notwithstanding, to continue to build on the hope that the statesmanship, which has erected the greatest Empire in history, will still honour the pledges made in 1917 and that, in due course, the irritating restrictions on India's economic and political freedom will disappear.

Restrictions on Loans.

Some financial results of India's dependent status merit attention. Unlike the Dominions, India is not free to raise sterling loans in Great Britain without the sanction of Parliament. The restriction descends from the days of the East India Company. Taken along with the absence of Indian legislative control of the loan operations of the Government of India, it has generated irritation and distrust of our Public Debt policy. External debts are usually unpopular, and lead to restrictions of the freedom of the borrowing countries. The grant of Parliamentary sanction to Indian sterling loans perhaps gives them a 'trustee' status in the British loan market. External capital has been necessary for India's development, and it will continue to be so, in a greater measure in the future, when large plans are taken up for execution. The removal of restrictive rule on sterling loans cannot prejudice British interests, while it will ease the situation, and diminish, the tendency for Indian opinion to prefer economic stagnation to development rendered possible only by outside borrowing. Legislative sanction in India, for *all* loan operations, is on the other hand very necessary to achieve the same object. The Indian legislatures have already the power to scrutinise expenditure. The power to sanction and

to scrutinize should be concurrent, and vest in the same legislative authority, in the interests of economy and convenience.

Rigidity of Expenditure.

Rigidity of public expenditure is another consequence of India's dependent position. The expenses of defence and of the ecclesiastical department, as well as the interest payments on the Public Debt, and the salaries and pensions of the statutory services are determined *for,* and not *by* India. The provision of these exclusions among the 'safeguards' in the White Paper is responsible for the volume and severity of Indian criticism. The excluded area of expenditure is vast. The exclusion blocks the development of India's resources. The progressive elements in the country are antagonised by a restrictive power, whose effects are cumulative. The ill-feeling caused by the 'safeguards' stands in the way of the whole-hearted co-operation of the national parties with the Government, which is necessary for a successful loan policy, and for carrying out big planning schemes.

Devolution and Provincial Autonomy.

Devolution of power implies that the Central Government divests itself of authority and confers it on provincial governments or on local bodies. Concentration of power at the centre must diminish in local authorities the knowledge and the interest necessary for the effective and beneficial use of power. Centralisation overburdens the executive, and correspondingly diminishes its efficiency. Decentralisation to competent and trustworthy authorities will promote it, as it will so distribute power as to make it effective. A Government gains strength by wise devolution, though, where an

effective and informed public opinion is absent, there is a risk that indiscriminate devolution of power to popularly elected authorities will lead to inefficiency and corruption. Independence and the sense of responsibility go together. In the sphere of Finance, Provincial decentralisation will promote increased efficiency in the collection of revenue, and increased economy in spending. A limit is imposed by size and population on the area which can be governed effectively. A forced unity, which brings together regions divided by history, race, religion and economic interest, will be unnatural. Decentralisation through the formation of provinces, based on organic unity,[1] and of a size neither too large nor too small for efficient government, tends to an increase of economic and political advantages. Scrutiny of taxation and expenditure in legislative bodies is effective in proportion to its reflecting intimate knowledge of local conditions, and, it is more in evidence in Provincial legislatures, than in the Central. Provincial autonomy accordingly implies more than decentralisation. Legislative and financial independence is among its essential elements.

As early as 1867, the idea of a United States of India, composed of *Sovereign* provinces, was adumbrated and became the subject of controversy.[2] John Bright championed such a scheme.[3] It was opposed on the ground that it is not possible in every case to localise resources and expenditure, that the apportionment of

[1] It is doubtful whether such organic unity can be presumed merely from the prevalence of a common language in the so-called 'linguistic' areas.

[2] See Minute by the Commander-in-Chief, Sir W. R. Mansfield, dated 17th October, 1867, in *Papers on the Extension of Financial Powers to Local Governments*, pp. 99-103, and B. R. Ambedkar's *Provincial Finance in India*, 1925, pp. 29-31.

[3] *Speeches of John Bright*, Ed. J. E. Thorold Rogers, 1868, pp. 103-4. The speech was made in August 1859.

military charges would be difficult, that the scheme would promote disunion and jealousy, and that the new synthesis would promote inefficiency and make the Central authority a mere figure-head. Lord Mayo's scheme of 'provincial contracts' was a half-measure, whose adoption was due to the need to curb provincial extravagance and to give the provinces an interest in economy. The case for provincial autonomy has been steadily gaining in strength for two generations. Denominational rivalry, and sometimes linguistic rivalry, have led to the demand for the formation of new provinces, united only by a common creed or by a common language. Full autonomy for all the provinces is now impeded by their unequal cultural and economic levels, and by the great differences in area, population and financial strength.

For real Provincial autonomy, financial freedom is no less essential than political, but the one does not necessarily imply the other. A province may have the right to raise and expend taxes. Resources raised by provinces under the sanction of their respective legislative bodies may be pooled, redistributed and controlled by a common fiscal authority.[1] The centralisation of collection and of expenditure has also to be distinguished. For Provincial autonomy, it may appear that control over expenditure is more important than control over revenue. It is often more economical to have the collection of the revenues entrusted to a central authority, and their allocation to the provinces according to a definite plan, on such bases as area, population, proportion of the revenue raised in the territory, needs,

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[1] As for instance, when ear-marked for financing agreed plans of development. This may lead to friction and the erection of a cumbersome machinery—dangers, which should be avoided.

etc.[1] An ideal financial settlement will appear to be one which will give every province resources adequate to its expenses, and full control over its own expenditure.[2]

Provincialisation of revenues and expenditure, according to a scheme of allocation of functions and resources on exclusive, concurrent, or overlapping bases, leads to *two* disadvantages. Firstly, some provinces are placed permanently in deficit and others in surplus, and, secondly, either the Central Government or the Province is unable to balance its budget from its own resources. In such cases, the financially weaker authority has to be helped by the stronger. If the obligation to help is laid by a formal instrument, as was the case in the Meston Settlement, its inelastic character deprives the affluent parts of any inducement to economy. This had been a patent defect of the Meston Award. If the Central Government is obliged to depend on contributions from the provinces, the feeling of dependence weakens it in the discharge of many normative supervisory and restraining functions. If, on the other hand, the provinces are obliged to look to the Central Government for help, their relative positions lead to encroachments on provincial autonomy. The grants made by the Central Government should be either statutory and unconditional 'subsidies', or conditional grants or 'subventions' for specific expenditure to be incurred subject to central supervision. Many in India would probably prefer the method of subventions. In the United States of America and Switzerland, the Federal Governments

[1] *Cf.* the recommendations of the Percy Committee on the allocation of the Income-tax. See Sir Walter Layton's *Memorandum,* op. cit., p. 211.

[2] The truth of this will be beyond dispute, if the funds are found by the Central Government; when they are not, the settlement will often work badly, as in a joint family, in which one member produces more offspring and cultivates a higher standard of life than the others and still clamours for more than his just share.

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have encroached upon the freedom of the states through the practice of subventions.[1] Such a result will not be welcome in India. To obviate it, a fiscal settlement which enables both the provinces and the Central Government to balance their respective budgets, must be devised. Such an equilibrium is not now attainable in India,[2] owing to the inequality between the provinces and the difficulty of continuing in perpetuity uneven levels in economic and social advance, in different parts of India. A regrouping of the existing provinces, so as to increase their number and reduce their disparity in size and population may help, but it will not finally solve the problem. The creation of new provinces[3] will impose fresh burdens on the tax-payer by the increase in over-head costs, duplication of administrative machinery, and overlapping. It is therefore to be deprecated. The task will be made still more difficult if Indian States are also brought within the arrangement, on terms of equality with the Provinces.

Responsible Government.

The demand for Responsible Government has a counterpart in the claim of the provinces to be allowed to administer their affairs without Central interference. It is itself part of the aspiration for democracy. A Government, which is not responsible to its legislature, finds it progress impeded in every direction. Its action is hampered in two ways. Firstly, it has to overcome

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[1] Bryce, *Modern Democracies,* II, p. 411; A. F. Macdonald, *Federal Aid,* 1928; Dr. H. Finer's Article on *Grants-in-aid* in the *Encyclopaedia of Social Sciences,* Vol. VII, 1932, pp. 152-155; B. P. Adarkar, *Federal Finance,* pp. 232-237. Subventions are criticised as divorcing expenditure from those who are, under the Constitution, empowered to control and criticise income.

[2] See the Reports of the Peel and Percy Committees and the White Paper.

[3] *e.g.,* Sind and Orissa, and the agitation for an Andhra province.

the difficulties which spring from the character, motives and the interests of those who hold power. Secondly, it has to face the resistance, silent but effective, of the masses. The contention that a Parliamentary Executive is in a better position to understand the wishes and the requirements of the people than an efficient bureaucracy like that of India, may be debatable. But, it is vain to entertain the hope that, with advancing political ideals, the people of India will rest satisfied with a Government, which is a mere engine of efficiency. It is a case of good government being less satisfying than self-government.[1] Provincial autonomy, if and when it comes, must carry with it the power of taxation.[2]

In the present constitution,[3] certain additional tax-resources are made over to the provinces under the Scheduled Tax Rules. The heads of taxation so transferred to the provinces and representing their financial reserves, comprise the following: a tax on land put to uses other than agriculture; a tax on successions; a tax on betting or gambling; an advertisement tax; a tax on amusements; a tax on 'any specified luxury'; a registration fee; and a stamp duty other than the duties fixed by Indian legislation. The list is long, but it shows the narrow basis of the taxation now reserved for the provinces. The provinces are to experiment with *new* taxes, not yet tried by the Central Government. It is of course difficult to increase the tax-resources of a province, without narrowing the field of Central taxation,[4] since the scope for the discovery of new tax-resources

[1] *Cf.* B. R. Ambedkar, *Evolution of Provincial Finance in British India*, 1924, p. 197 and M. Ruthnaswamy, *Political Theory of the Government of India*.

[2] See Resolution, dated 18th May, 1912, of the Government of India, which admitted this principle.

[3] *i.e.*, in July 1934, when the Lectures were delivered.

[4] B. R. Ambedkar, *op. cit.*, p. 247.

is very small. In provincial as in Central finance, the conclusion seems irresistible that the financial reserve should be sought less in new taxation than in an increase of the taxable capacity, brought about by a planned all-round development of the resources of the people.

The taxing powers now given to the provinces are supplemented by the permission to raise loans for provincial purposes. The right to raise such loans in the open market was conferred for the first time by the Government of India Act of 1919.[1] The purposes for which provincial loans may be raised, and the conditions under which the debts can be contracted are all specified in Rules. The recent history of provincial borrowing in India reveals, firstly, the absence of any clear policy in regard to the occasions for incurring provincial debt, and, secondly, the relatively higher rate of interest paid by the provinces as compared with the Central Government. If the average rate of 6·7 per cent. on the actual rates of interest charged for provincial loans, in the decade following the Reforms, be considered in relation to the average rate for Central loans, it will be noticed that the rate charged to the provinces is ½ per cent. more than that paid for the Central loans. For this difference various explanations have been offered.[2] The market for Central loans is of course wider than that for provincial loans. Provincial borrowing has not coincided in this period with any extension of their developmental side, under the control of the Ministers. This lends some weight to the complaint that the provinces have largely resorted to borrowing, to avoid unpopular additional taxation, and to conceal the results of their own bad economy. A habit of borrowing, in provinces as in

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[1] Section 30 (1) (*a*).

[2] *Cf.* D. L. Dubey, *Indian Public Debt*, 1930, p. 131 f.

individuals, leads to relaxation of economy, and opens the door to financial disorganisation.[1]

In the distribution of functions, the responsibility for economic development now rests more on the Provinces than on the Central Government. It will continue to be so in the future. Safety measures will therefore have to be devised to ensure that provincial loans are raised only for planned development and on advantageous terms and that the funds so raised are economically utilised. It is but fair that a generation should not be burdened with taxation for the provision of advantages which are to accrue to future generations. Equity also requires that the mistakes or extravagance in planned or unplanned expenditure of one generation should not be passed on to the succeeding generations. If the necessary control is not to be found in the sense of an increased consciousness of social responsibility in the provincial Legislatures, the interests of economy will by themselves justify a certain degree of restriction of provincial autonomy and an enlargement of central supervision.

Federation.

From Provincial Autonomy to Federation is but a step forward. The Reforms of 1919 and the consequent Meston Settlement moved in the direction of federation by the clear cut division of tax-resources, the division of fiscal power and functions between the central and provincial Governments, the separation of Provincial and Central Accounts, the budgetary independence of provinces, and the grant (under the Meston Settlement) of substantial spending powers to the provinces, as a partial compensation for the contributions they were to make to the Central Government. The impulse to

[1] *Cf.* Gyan Chand, *Financial System of India,* 1926, pp. 308-9.

federation has been strengthened by a desire to bring the Indian States into closer relationship with British India, and by the favourable experience of partial responsibility in the Government of the provinces, under dyarchy.[1] In many minds there is also the feeling that responsible government at the centre as well as in the units will be more rapidly attainable in a federal than in a unitary scheme. It is sometimes forgotten that rationalisation is needed for India's development, that arbitrary political barriers are now obstacles to the integration of economic life, and that their emphasis in a federal type of organisation may counteract the tendency to rationalisation.[2] Political union or unity is preferable to a loose synthesis, which exaggerates local interests and sentiment. The classical view of federation stressed the existence of a "double-government, a double-allegiance, and a double patriotism",[3] and the existence of a feeling in the citizens of more attachment to their respective States than to the Federal State. These features are not conspicuous in all parts of present day India, though in the Punjab, Bengal and Sind, local feeling stimulated by religion or the passion for the local vernacular, has created a kind of local patriotism. At their strongest, they represent separatist tendencies, for which the effective corrective is Provincial Autonomy. In India Federation is now an imposition and not a growth. The component units of the proposed Federation are very unequal in size, strength, culture and capacity for self-government.

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[1] Opinion on the success of dyarchy is divided; *e.g.*, "Kerala Putra's" *Working of Dyarchy in India*, 1928, *passim*.

[2] The concessions made to the Indian States to induce them to come into the federation are likely to impede the conjoint economic development of 'India' and 'British' India.

[3] *Cf.* the remarks of H. N. Brailsford in the *Encyclopaedia of Social Sciences*, VII, p. 671.

The inclusion of the Indian States will introduce other complications, the chief of which is the stabilising of monarchy and personal rule in the States, by guarantees incorporated in the fundamental laws of the Constitution or by special 'instruments of accession'. Indian federation will be an unstable association of peoples and personal rule.[1] The guarantee of the political *status quo* of the Indian States, explicitly or implicitly in their entry into Federation, will put off indefinitely the removal of inequality within their borders. The inclusion of the Indian Rulers in the Federal governing bodies, may, it is feared, strengthen the forces of conservatism and reaction. On such grounds, grave doubts are entertained as to whether in India's interest, the evolution of full autonomy at the Centre and in the provinces of British India is not preferable to the 'shadowy advantages' of a Federation of the type that is now in the making.

The arguments against Federal India are reinforced by fiscal reasons. There is a rough equality and uniformity in the financial systems of the provinces, but there is none between them and the Indian States, or between the Indian States *inter se*. If the necessary uniformity and harmony of financial arrangements and policies are to be brought about, it will necessitate a great addition to the normative powers of the Federal Government, and the imposition of specified common standards of economic and administrative efficiency on the States, as pre-requisites of their entry[2] into the

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[1] This is recognized by political officers of experience. *Cf.* Sir William Barton, *The Princes of India,* 1935: "To exercise their full weight in the new order of things, the Princes must have their people behind them, which is not always the case to-day. Absolute autocracy and responsible government can hardly exist indefinitely side by side."

[2] See the proceedings *passim,* of the first session of the Round Table Conference, and especially the observations of H. H. the Maharaja of Bikanir and Sir Akbar Hydari.

Federation. It would be well to incorporate in the Federal 'rules of accession' a provision to ensure this. But, though good in itself, such a guarantee is contrary to the spirit of federation. On the other hand, the terms on which States have declared their willingness to enter the Federation appear to suggest a confederation more than a federation, as their goal. They have asked that their autonomy and dynastic positions be guaranteed; that they have federal and a non-federal spheres of action, in the former of which they will stand outside the Central Government and in direct relation to the Crown through the Viceroy; that their subjects be immune from direct federal taxation; and that they get substantial representation in the Central Legislature. The White Paper of 1933 proposed that the Corporation Tax,[1] and a surcharge on the Income-tax should be imposed on the Indian States, but the suggestion was not acceptable to them.

All the same, it must be admitted that there is a desire in India to federalise. This is so both in British and in *some* parts of Indian India. It is but natural. Federalism has the great merit of adaptability, considered as a form of political synthesis. It cuts across all classifications of Government types and can therefore equally fit in with monarchies or republics. It is tolerant of political mixtures. It is a useful compromise. Long ago, political thinkers saw in Federation the predominant political type of the future.[2] Recent political thought[3] has questioned the monistic conception of the State and Society on the ground that it ignores the complexities of life. The basic aspect of federalism is pluralistic. It stresses the need for unity

[1] Para. 57.

[2] *e.g.*, H. Sidgwick, *Development of European Polity* (1903), p. 439.

[3] H. J. Laski, *Grammar of Politics*, 1928, and his other writings.

in this diversity, and advocates an organisation of political life, which will develop unity without destroying variety. Such a union is 'federal'. The value of the federal type, according to this school, lies in the variety and the wealth of experience and outlook it presents. The vastness and diversity of India might, in this view, strengthen the case for federating it.

The search for political ideals has been stimulated in India by the discussions on constitutional and political reform, and the attractions of Federalism have become conspicuous in the inquest. Federalism is acclaimed as the ideal because it substitutes co-ordination for subordination, reciprocity and understanding for compulsion, persuasion for command, and law for force. Federalism postulates further federations, and a concert of nations, and the establishment of universal harmony. It leads to internationalism and pacificism.[1]

The desire to bring the Indian States into the Federation has to some extent delayed the constitutional settlement. There cannot be two Indias, socially and economically. In spite of the existence of the States, the tendency to union has been pronounced. Geographically and ethnically the Indian States march with the British Indian districts, amidst which they are imbedded. They cannot expect to become an Indian 'Ulster'. They have not the special advantages of homogeneity and differentiation from the rest of the country, as well as the defensive powers and economic superiority, which have made it possible for Northern Ireland to stand outside the Irish Free State. Nor can Indian States permanently remain separate from a United British India. No 'Inland Customs Line', and

[1] See the lucid article by Prof. Max Boehm of Berlin in the *Encyclopaedia of Social Sciences*, VI, 1932, pp. 169-172. Othmar Spann has tried to popularise federalism as 'Universalism'.

no restrictive legislation, aimed against the 'levity' of the Press, can prevent the penetration into their territory of modern ideas. Such of the States as are politically or economically backward evoke sympathy outside their frontiers. The embarrassments of several Indian States to-day spring from the ardent sympathy manifested towards their subjects and their grievances, real or imaginary, by the people of the adjoining British areas. Absolute monarchy no longer commands the consideration, which it enjoyed. Few Indian dynasties have an uninterrupted connection with the hoary past. Many of the most powerful States are the products of the eighteenth century, and their title-deeds are not therefore very much older than those of the Zamindars of the Permanent Revenue Settlement. The psychological bias of the Indian for the monarchical form of government is largely a myth. The sheet anchor of the Indian Rulers is their belief that the Paramount Power will respect treaty engagements. The hope is generally well-founded. The British nation, which declared that it risked all, and entered with open eyes on the most disastrous War of modern times, to secure the inviolability of the pledges contained in a 'scrap of paper' cannot treat its treaties with the Indian States, which live up to the spirit of their engagements, as mere waste paper.[1] The Paramount Power also cannot remain indifferent to or unaffected by the new ideas, which stress the popular more than the personal aspect of political engagements. An observer hardly overstated the case, when he said: "Indian opinion is overwhelmingly in favour of an absorption of the Indian States with the adjacent areas. The Indian nationalist is confident of the economic and political benefits of annexation." Indian trade and industry are restive

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[1] See Nicholson, *Scraps of Paper*.

under the barriers erected by artificial political boundaries. They will welcome a union in which the impediments will be removed. Such local sentiment as the States have engendered or nourished, or conserved, is hardly yet vocal enough to challenge outside opinion and plead for the retention of State individuality.[1] We are now in times in which, as already observed, contractual obligations are melting. Treaties are after all only contracts. It may therefore be not wise for Indian States to build their hopes of indefinite existence as separate units, on the terms of their treaties, even if their claim to do so can now be reinforced by the ingenuity of modern legalism. The path of wisdom for the Indian Princes lies in the direction of willing cooperation with the progressive forces both in British India and in their own territories, and in an advance towards a closer union, based on the recognition of common aims, interests and difficulties. From their social position, Indian Princes are naturally singled out for leadership. Several of them are patriotic statesmen of courage, resource and vision. To such leaders, neither the inclination nor the desire born of wisdom, will be lacking to inspire them to follow the example of the *Samurai*[2] of Japan and voluntarily surrender a part of their special privileges in the interests of national unity and prosperity. If these leaders can carry their fellow-princes with them, the Indian States will ride on the crest of the waves of public opinion, which would otherwise engulf them. To-day they can get reasonable terms; their chances of being able to obtain them in the future are diminishing steadily.[3]

[1] There is a good deal of popular feeling in favour of Federation in some India States, *e.g.*, Mysore.

[2] Cf. *Encyclopaedia of Social Sciences*, IX, p. 287, on 'Leadership'.

[3] The observations have been largely justified by the course of events since July 1934, when they were made.

The adhesion of the States to a federated British India is by no means easy, and it cannot be made all of a sudden. Many difficulties, arising from the varying sizes of Indian States, the minuteness of most of them, and their special economic difficulties, must be first overcome. There is hard work ahead in resolving such difficulties by grouping States, and by fixing minimum standards of educational, administrative and economic efficiency for accession to the Federation and by strengthening their fiscal position.[1] The fiscal demands of the Indian States, as a condition of their joining the Federation, need careful consideration from the Paramount Power as well as from the student of Federal Finance. The States now demand that the tributes which they have been paying to the Paramount Power, should be abolished. The aggregate amount of the tribute is well under a crore. They vary from 24·5 lakhs paid by Mysore to Rs. 100 for which Ramrai in Assam is liable. Tributes are viewed as carrying the 'taint of ascendency'. It is urged that while they may have their place in an *Empire,* they can have none in a self-governing federated India.[2] In some cases they may be treated as insurance premia paid by the States for the perpetual retention of their independence; in others, they may be viewed as money compositions for defence; in others again, they may be regarded as compensation for the Paramount Power's not exercising the rights of annexation after conquest; and in others, still, as marks of the quasi-feudal relationships of an Indian Protectorate.

Neither historically nor logically can the tribute be treated as a contribution for India's Defence expendi-

[1] There are only a score of States whose annual revenue exceeds 50 lakhs, the income of a small British District. Their size and population might hardly be held to justify equality of treatment in a federation with the big Provinces.

[2] Gyan Chand, *Federal Finance,* p. 330.

ture. In some cases, the cost of the subsidiary forces was originally arranged to be met from territories, which were then and there assigned away or ceded by the States. These areas have since been incorporated into British India. It is claimed that the cessions of territory bar any further demand for payments for defence. The forces maintained by some of the States are also pointed to as an additional contribution to the common defence. On the other side, it is argued that a ceded territory must be treated as once for all absorbed, that in many cases the cessions were of areas to which the ceding parties had not established their title, and that in any case, they cannot *now* be held to bar the duty of the States to contribute to the cost of common Defence in accordance with *modern* military requirements.

The States argue that their subjects are now taxed by British India on the articles which they consume, on the currency which they use, on the letters which they put into the Post Office, and on the journeys which they undertake on the great trunk lines of railway, which pass through their territories. Inland States particularly are involuntarily participating in the effects of the tariff policy of British India. Individual claims of a specific character have also been put forward by certain States. The settlement of questions involving about 700 units, ranging in size from a few acres to that of a European kingdom, and of issues springing from over a century of political relationship, has necessitated their prolonged scrutiny from different angles. We have now had in India *three* Commissions of enquiry, which have dealt in succession with the position of the Indian States *vis a vis* British India and the Crown, the repercussion of a scheme of Federal Finance on the States, if and when they should

join the Federal Union, and the general and specific claims of the States against the Paramount Power, as based on treaties and abstract justice.[1] The arguments on both sides have been stated publicly, and with ability and force. All the enquiries have upheld the necessity for maintaining Paramountcy unimpaired, and in the case of a Federation, the dominating character of the needs of the Federal Government over those of the States. The restoration of the rights of coinage, independent Post Offices, etc., to the States, which have surrendered them, has been held to be impracticable, and the continuance of such rights in a few States as impediments to the freedom of economic intercourse internally and interstatally. In any Federation, even on the *sole* ground of a need to prevent Double-taxation in the case of indirect taxes, there is justification for the reservation of Customs as a source of Federal income, and a refusal to the component States of the right to levy import and export duties. The Davidson Committee, after a detailed consideration of the claims put forward by the States individually, summed up the *debits* to be admitted by the Crown as approximately totalling one crore a year.[2] With the abolition of the tribute, this will imply a *gift* of two crores out of Federal income to the Indian States, as part of the price of their accession, the other concessions being the guarantee of the internal freedom of States, of their dynasties, and of their exemption from Central direct taxation. The White Paper has

[1] These are the Butler, Percy and Davidson Committees of 1928-29, 1932 and 1932, styled respectively Indian States Committee, Federal Finance Committee and Indian States Inquiry Committee (Financial). Since these lectures were delivered, the case for the Princes has been presented before the Government of India and the Secretary of State for India, during the passage of the new Government of India Act in the House of Commons.

[2] Vide its *Report*, p. 155.

proposed to apply the Corporation-tax to the States for Federal purposes, and the suggestion is being resisted.[1] British Indian opinion is opposed to subsidising the States, even for the purpose of promoting a federal union.

The Federal Finance Committee has suggested a division of revenue between the Federal Government and its units.[2] It proceeds on the basic assumption that the estimates do not envisage the liability of the Federal Government to expenditure on welfare activities. The scheme as finally incorporated in the Government of India Act is on the lines followed generally in a division of federal resources, with slight modifications suggested by Indian conditions. Customs, Railways, Currency and Coinage, and Commercial undertakings are to be Federal assets. While the export and excise duties are to be levied and collected by the Federation, power is given to distribute the net proceeds of such taxes to the federating units. A certain percentage of the personal income-tax is to be permanently assigned to the provinces after a prescribed interval. The Corporation tax is to be Federal. Land revenue, forests, restrictive excises, stamps, succession duties and terminal taxes are to be provincial, but for securing uniformity, the last three duties are to be levied and collected by the Federation on behalf of the units. Although securing some elasticity, the defect of the scheme is that it does not look beyond the *immediate* future and fails to provide resources in the *centre* or in the States, for welfare activities, which will secure the civic minimum for the nation.

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[1] Vide its *Report*, p. 62. Since the above was written, the Government of India Act has been passed which provides for the levy of the Corporation tax in the States only after ten years from the date of the establishment of the Federation.

[2] Vide its *Report*, pp. 28-30.

Division of powers is a cardinal issue in Federation. It is possible to secure a graduation of centralisation, passing from one extreme to the other. The method of division usually followed is to enumerate the powers of the Centre and the parts and indicate how the residuary power is to be enjoyed. In the United States of America, the States have all the powers, which are not specifically or by implication granted to the Federal Government. In the Canadian constitution the powers of both the Federal, as well as of the Provincial Governments, are 'enumerated', and the classes of undefined powers are reserved for both, the Federal residuary power being the wider. In the new German constitution, both authorities have either concurrent powers, such as 'the maintenance of public order and security',[1] and in cases of conflict Federal Law overrides State Law.[2] The Federal Legislative powers in Germany are now of *four* kinds, *viz.*, exclusive, concurrent, conditional and normative. The last power confers upon the Federal Government an authority to set up *norms* or standards, which are to be adhered to by the States. It has been acclaimed as a valuable contribution to Federalism. Federal supremacy is viewed as in no way inconsistent with State independence. The actual power of the Centre or the States depends on the *functions* assigned to each, and not on the possession of the residue of power, by the one or the other. Australia has invested its Federal Government with the powers to control Banking, Insurance, Pensions, Marriage, etc.,

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[1] *The German Constitution,* Arts. 7, 8 and 9 "So long and in so far as the Reich does not make use of its legislative power, the States retain that power for themselves." This does not apply to the exclusive legislative power of the Reich (under Art. 6).

[2] Art. 12. B. Shiva Rao, *Select Constitutions of the World,* 1934, pp. 210-211.

Art. 13: "The Law of the Reich overrides the law of the State. *Ibid.*, p. 212.

making it stronger than the Central Government of the United States of America. In India, it will be more necessary than in other Federations to maintain the strength of the Central authority. Indian Federation will be the result of the disintegration (or re-organisation) of a unitary State. The residuary powers in India will tend therefore to remain automatically with the *Centre*. Normative powers, such as those now given to the Federal Government in the German Reich, will be very necessary for the Federal Government in India, as it will have to provide for the regulation of common interests, laying down common standards, and securing the proper observance of their appointed duties by the several agencies.

The division of financial powers in the Federal State must correspond to the allocation of functions. A State is sometimes described as "the sum of its financial capabilities".[1] Financial authority is the complement of political.[2] In the division of duties, the expensive welfare functions, such as education, irrigation, industrial construction, etc., may impose heavy burdens on the party which gets it, unless it receives simultaneously the powers which will secure to it a sufficient and expensive revenue, to meet such developmental expenditure. Welfare finance inflates a budget. The economic pursuit of welfare is often possible only under unity of plan and execution. Welfare schemes cannot always be localised as regards their *effects*. Such instances raise the question whether development functions should not be assigned exclusively to the Central Government. If development is possible only by the contraction of

[1] A. Hensel, *Der Finanzausgleich im Bundes taat,* 1922, cited by B. P. Adarkar, *Federal Finance,* p. 31.

: See also 'Local Finance' in *Encyclopaedia of the Social Sciences,* IX, 1933, pp. 568-574.

[2] H. Finer, *Modern Governments,* 1933, p. 315.

large loans the general advantage of the unified control of the Public Debt operations will furnish an additional reason for the centralisation of development work. If in the alternative, it is left to be attended to by the units, assisted by Federal subventions, and the intervention of the Federal authority is only to see that the subsidies are properly utilised, according to the norms set up, the arrangement will prove in effect an infringement of State autonomy, and worse than leaving to the Central authority both the resources and the spending powers. The question is complex and must be answered in the light of experience. In the case of India, the decision will have to be based on a review of comprehensive schemes of development, considered as a whole as well as in their main divisions, like education, sanitation, communication, etc. As a result of such examination, it will probably become necessary to revise the allocation of functions hitherto recommended by various Committees.

There are now four functions which the Central Government in India discharges. They are 'Resource operations', 'Ways and Means operations', 'Accounts' and 'Audit'. The constitution of the Reserve Bank and its expansion through branches, should relieve the Federal Government of the first of these duties, by attending in future to the provision of funds as and where they are needed. With the grant of powers of Provincial taxation, the second duty will devolve on the Provinces. 'Accounts' may also be provincialised, but 'Audit' will have to remain a central function. As Sir Guy Fleetwood Wilson urged in 1913, "the only way to insure honest and sound finance is to subject expenditure to the search light of *independent* Audit". A Federal Judiciary is not more necessary to safeguard the Constitution than a Federal Audit. Even at pre-

sent, the duty is laid on 'Audit' to call attention to illegal fiscal action, to extravagance and to waste.[1] Independence is as essential to 'Audit' as to the Judiciary, to ensure that the work is done fairly, boldly and impartially. Efficient audit requires as an antecedent condition an intimate knowledge of the actualities of administration. Audit must therefore be based on experience and be related to realities. These requirements will necessitate the amalgamation of the Accounts and Audit services, and the formation of a common cadre, under Central control, and outside political influence, serving as a Service-reservoir from which the necessary accountants or auditors will be drafted for work at the Centre or in the Provinces, as occasion requires.

Local Finance[2]*: General.*

The consideration of the fiscal implications of Federation naturally suggests the more general relations of Central and Local Finance, which have received marked attention in recent times. There are analogies between the two parallel subjects. The vast increase in local expenditure has been a noteworthy feature in all advanced countries, since the War. This has been due in a large measure either to devolution or enfranchisement, widening the range of the activities of Local Government, or to the recognition that certain Government functions are better discharged by local than by central authorities, and that this is implicit in their assignment to Local Government. Since the War,

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1. *Indian Audit Code*, p. 147 or the official *Introduction to Indian Government Accounts and Audit* (ed. Sir E. Burdon, 1930), paras. 354-357.

2. Article on 'Local Finance' in *Encyclopaedia of Social Sciences*, IX, 1933, pp. 568-574; Report of the *Royal Commission on Local Taxation in Great Britain*, 1901; *Report of the Departmental Committee on Local Taxation*, 1912; *Report of the Indian Taxation Enquiry Committee*, 1926, Vol. I, pp. 279-337.

there has been a marked acceleration in the rate of the increase of welfare activities financed by the State. In the twenty years following 1910, the expenditure in Great Britain on social services increased nearly sevenfold, and their administration was mostly made over to the local authorities. The British Local Government Act of 1929, which consolidated and harmonised the current practice, is a landmark in the history of national and local finance, and contains some of the most satisfactory solutions of the problems of grants-in-aid.

As regards revenue and expenditure generally, the modern trend is in the direction of centralisation of revenue and decentralization of expenditure. Local authorities in Germany, since the War, cannot impose any tax, which the Central Government chooses to reserve for itself. In Soviet Russia, the revenues are almost entirely centralised. Even in the United States of America, the present tendency is to have State-administered and locally-shared taxes. Local bodies everywhere have little scope for taxation. All forms of indirect taxation are closed to them. They cannot levy customs. The *octroi,* which used to be levied on goods entering towns, is now in disfavour as an impediment to internal trade. *Local* excise duties are open to evasion and corruption. Similarly, many forms of direct taxation are unsuitable to local bodies. Taxes on income and inheritance must clearly be under the central authority, as neither income nor inheritance can be always localised.[1] To do otherwise will be to foment disputes, increase evasion and cause double-taxation. Nor can the wealth of corporations be localised. Holland, which had tried a local Income-tax, had to abandon it

[1] Austrian provinces and cities have had local inheritance taxes, over and above the inheritance tax levied by the central Government. *See* W. J. Shultz, *Taxation of Inheritance,* 1926, p. 96.

in 1929. The only openings left for local authorities are in taxes on real estate, buildings, business, and beneficial expenditure (*i.e.*, 'betterment').

The present narrow base of local taxation and the expansion of local expenditure, render central contributions inevitable. The entire expenditure of local bodies in Soviet Russia is met by the Central Government. In the United States, subventions amounting sometimes to a fourth of the local collections, are made by the Federal Government to the States. Such contributions are now supported on the additional ground that they will equalise wealthy and poor localities. Recent European practice is in favour of complete centralisation of borrowing. This is so in Great Britain and virtually so in France, where a central provision for loans to local bodies is made through a *Caisse de Credit aux Departments el aux Communes.* There are similar Central agencies in Belgium and Germany. Everywhere, local finance is subject to central audit, and in some countries (*e.g.*, Germany and France) to rigid central control.

Local Finance in India.[1]

The weak spot in the Indian fiscal structure is local finance. It is due to causes chiefly of a historical character. Unlike the countries of Europe, where self-government began in the local units and developed into autonomy at the top, the process of the formation of local self-governing bodies in India has been through the devolution of powers by the larger to the smaller units. The solitary exception is that of the Village Panchayat, whose revival was strongly urged by the

[1] See generally, Ch. XIII, pp. 305-336 of the *Report of the Indian Taxation Committee;* Resolution of the Government of India, dated 28th April, 1915, on Local Self-Government Policy; Reports of the Municipal Taxation Committee, United Provinces (1909) and of the Committee on Local Taxation, Bombay (1915); and Dewan Bahadur N. Gopalaswami Aiyangar's Memorandum.

Decentralisation Commission of 1909,[1] and whose powers of taxation, the Indian Taxation Committee[2] desired to see restored. The chief institutions of local self-government are thus the creations of the Indian legislatures since 1871. The main distinction between local bodies is that between urban and rural. The Municipalities, now numbering 781, come under the former category; and in the latter, beginning from the bottom, are Village Panchayats, Village Unions, Taluq Boards, Sub-district Boards and District Boards. There were 207 District Boards (except in Assam) with 584 Sub-district Boards in 1931-32, as well as 455 Unions and Panchayats in Madras. In Bengal there were 4,510 Union Boards in 1930-31.

There has been very little growth in either the number or the range of the duties assigned to the local bodies. Taluq Boards, which have smaller jurisdictions than Sub-district Boards, functioned in Madras till recently. The fiscal ground of their abolition is the increase of overhead costs due to the existence, side by side, of District and Taluq Boards, both of which had to tap the same sources of revenue. The tendency now is to replace them both, by new boards controlling areas smaller than the present districts and larger than the taluqs.

The Indian Municipalities are entrusted with the duty of providing for education, public works and communications, while the Rural Boards have in addition the functions of seeing to the upkeep of communications, and occasionally giving famine relief.

In regard to their resources there is a difference. Municipalities derive their income from *octroi*

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[1] Report of the Royal Commission on Decentralisation, 1909, para. 699.
[2] *Report*, p. 323.

(Northern India, Bombay and Central Provinces), taxes on houses and lands (Madras, Bombay, Bengal and the Central Provinces), taxes on professions and trades (the United Provinces and Madras), taxes on carts and vehicles, as well as rates and fees for services rendered in the shape of conservancy, water-supply, and the provision of slaughter-houses, markets, and schools. Road-tolls, which were recently abolished in Madras, formed an important source of revenue in that presidency, as well as in Bombay and Assam. In some provinces the Rural Boards have also relied upon road-tolls and profession-taxes, but their main-stay everywhere has been the surcharges on land revenue (usually referred to as 'cesses'), which since the reforms of Sir Edward Baker in 1905-06 have been retained solely for local purposes.[1] The purpose of a cess is often signified in its title, *e.g.*, road cess, education cess, etc., but the basis of assessment has always been the land revenue or the rental value of land. Municipalities have had a wider revenue-base, since they derive income from the house-tax (based on capital value, dimensions, annual rental and nature of structure), taxes on sales, licence fees, and fees for occupations of municipal sites or structures. The bigger and more modern type of India's municipality is beginning to derive a growing income from the public utilities, which it provides, manages or controls, as wells as from railway terminal taxes, pilgrim taxes and taxes on entertainments.[2] The rough fourfold classification of the sources of municipal income as fees and licences, and as taxes on trade, property and persons, adopted by the Taxation Enquiry Committee[3] shows how very largely the Indian

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[1] *Report of Indian Taxation Committee,* p. 304.

[2] Some district boards, *e.g.*, in Madras presidency, own railways from which they derive a revenue.

[3] *Report,* p. 290.

municipality relies on indirect taxation. The local boards are somewhat differently placed in this respect but their revenue-base is even narrower.

The incidence of municipal rates and taxes in 1931-32 was only Rs. 5-8-8 per head of the urban population, and the corresponding figure for District and Local Boards was as low as Rs. 0-9-7, for the whole of British India. Only about a third of the total income of municipalities now comes from rates and taxes. About a crore out of an aggregate normal income of Rs. 17 crores for all municipalities in 1931-32 was from grants made by the Government or from Local Funds.

The chief fiscal defects in the organisation of local bodies are the dissociation of the powers of assessment and expenditure in local bodies, inefficiency in assessment and collection in municipalities. Both classes rely largely upon antiquated types of revenue like octroi, tolls and terminal-taxes. The practice of local finance in India is thus markedly in contrast with that of the West, and indicates a tendency to rely on a haphazard collection of fiscal heads, without consideration of the effects of their operation on local welfare and the development of habits of civic responsibility. It is noteworthy that though local self-government was one of the earliest areas of administration to be transferred to elected Ministers of the Provinces, their administration under dyarchy has tended to an increase of centralisation and of intervention of the Government in the daily activities of municipal and rural bodies, belying the hopes which were raised in 1882 of the local bodies becoming the fertile seed-beds of democracy in India.

Double-taxation.

Federation raises the problem of Double-taxation. In a unitary political organisation, like India to-day, the

problem crops up only when the principle of progression is applied to a tax source, which is provincialised. If, for example, the Land-tax, which is virtually a tax on agricultural incomes, and is now a provincial head of revenue, is brought within the ambit of the principle of progression, cases *may* occur in which the principle will have to be applied to the income of a person who has extensive estates in more than one province. It also arises in the case of licence taxes (*e.g.*, on motor cars). In a Federal State the question will come up more frequently, and so also in international relationship. The problems do not materially differ, whether we take a federal or an international case. When from extra-fiscal motives, progressive taxation is applied to particular classes of persons, Double-taxation *can* lead to excessive and unfair burdens. The operation of two disparate systems of levying the same tax, *e.g.*, the Income-tax, may lead to an unintentional discrimination. The selection of the same source, *e.g.*, income from land for taxation, on divergent principles, is however not Double-taxation. The suggestion that the income of landlords should be subjected to a supplementary levy,[1] on the principle of the French *centimes additionales* is not Double-taxation, in the objectionable sense of the term. The selection of divergent principles for taxing the same source may make a person who owns it, in two different jurisdictions, pay the maxima in both, or escape payment altogether.[2] If different persons are taxed on the same income it constitutes a mistake, and not Double-taxation.

The Income-tax is now levied in thirty-two Indian States, but their principles of assessment vary. The persons, who suffer most from it, are those engaged in

[1] *e.g.*, the levy of the road cess by the District Boards.
[2] Cf. Shultz, *Taxation of Inheritance*, p. 235.

business in both British India and the States. Since 1926,[1] the Government of India has provided a *partial* relief for such persons by sanctioning a refund of one-half the rate of the State tax levied on the income, provided it does not exceed one-half the British Indian tax. The arrangement is reciprocal. In a Federal State the most convenient way of avoiding Double-taxation is to federalise the taxes or the objects which are specially liable to it (*e.g.*, taxes on incomes, inheritances, corporations, etc.), and subsequently, share the proceeds, if necessary, on some agreed principle, with the provinces.[2]

The essential difficulty in dealing with double-taxation is to discover a common principle, which will be equitable in all cases. The place of origin of the taxed object, its *situs, i.e.*, the place where the object is to be found, the domicile or residence of the owner, and the place where the rights are enforceable, have all been suggested as guiding principles. The League of Nations Expert Committee on Double Taxation, which consisted of Professors Bruins, Einaudi, and Seligman, as well as Sir Josiah Stamp, after a consideration of alternative principles, recommended the acceptance of *economic allegiance* as the most satisfactory test. But, the virtual impossibility of allocating the exact proportion of economic allegiance to origin or domicile, in every case, was admitted.[3] This confession led to the rejection of the suggestion by the League of Nations Finance Committee. The restriction of 'double' Income-tax relief to its own nationals, following the practice of the United States of America, Canada, Italy and Belgium, and taxing *all*

[1] *Vide* Notification (Finance Department), dated 1st July, 1926, reprinted in Mr. V. S. Sundaram's *Law of Income-tax in India*, 1928, pp. 895-898.

[2] This is the suggestion of the Percy Committee.

[3] *Report on Double Taxation*, 1923, p. 39.

incomes of Indian origin at the source, including pensions, dividends and interest on securities paid in England for Indian incomes, is now advocated on this principle. The primary duty of India is to its own citizens.[1] The absence of relief to Indians subjected to Double-taxation in the Dominions and in foreign countries calls for suitable and prompt action.[2]

In India, appeals on assessments are to executive authorities except on points of law. The divergence of decisions in the Indian High Courts illustrates the difficulty of proper adjudication by judges, who do not possess the necessary double experience of law and finance. A separate *Financial Judiciary* like the Federal Finance Committee in the German Reich (*Reich finanzhoff*) is necessary for India. That Court now decides in Germany the legal compatibility of State and local taxation *inter alia.*

Some Administrative Problems: Audit.

The financial system of India presents many features, which are admirable, and some which are anomalous. Great Britain's trustee position has been responsible for the exaction of correct accounts of the Indian administration, and for the independent audit of Indian finances for the information of Parliament. In British finance, the supremacy of the Treasury is a cardinal feature: the Treasury has nearly always the last word, subject of course to the Cabinet's over-riding power. In India also, Audit has received much attention. The Auditor-General's independence is sought to be ensured by excluding his appointment from the purview of the local Government, and prohibiting his re-employment under the Crown.[3] The Central Accounts and

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[1] Rao, *Taxation of Income in India,* pp. 222-23.
[2] *Ibid.,* p. 231.
[3] He can however be employed, after retirement, in an Indian State.

Audit Service is recruited with care. Decentralisation necessitates the separation of the duties of accounting and audit, in Provincial administration as much as in the commercial departments, like the Railway, where it has been a success.[1] The assignment of important functions to the new Reserve Bank will create a new field of responsibility for the Audit staff. Audit is valueless unless it is efficient and independent. The provincialisation of Audit and the absence of a provision for Federal Audit will both spell disaster. Except in the commercial departments, Audit is now confined to expenditure, because the audit of income is obviously best done by the departments concerned. Nevertheless, it will be both feasible and helpful, in the interests of efficiency, if an independent audit of the income side also is established.[2]

Financial centralisation has not only led to the centralisation of Treasury control in India, but it has created authorities like the Central Board of Revenue, the Railway Board, etc. Their number will increase when Federation comes.

Budget.

The distinguishing mark of a modern State, which several Indian States still lack, is the Budget. As already shown,[3] the extension of the budgetary period, at least so far as consolidated grants are concerned, to a longer period than a year will be necessary when

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As such appointments depend largely on the good opinion of the Government, the hope of securing them can be looked on as contravening the spirit of the Statutory rules.

[1] The separation of Accounts and Audit has now been given up in the Province, which tried it, *viz.*, United Provinces.

[2] The Auditor-General is even now empowered, but not *enjoined*, to conduct an audit of receipts, to the extent he considers necessary, if so desired by a local Government.

[3] Vide *Supra*, p. 69.

large schemes of development are taken in hand. An alteration in the dating of the financial year or at least the presentation of the Budget at a different period from the present, is also desirable. Both the Chamberlain Commission and Lord Meston favoured the change. There is now a considerable interval between the time of estimation and of execution, which must be curtailed. The British practice of presenting the budget after the commencement of the financial year will obviate this inconvenience, though by necessitating short-term borrowings it may involve some additional expense.

Legislative scrutiny to be efficient must be facilitated by the extension of the time available for the examination of the Budget.[1] 'Parliamentary' control requires also that the estimates should be prepared with care in order that the necessity for supplementary grants may be avoided. Loan transactions should be shown in the estimates. The Central or Federal Budget must not be restricted to a statement of its transactions only but must present a conspectus of the finances of the whole country. The proportion of non-votable items should be reduced. Emergency powers of certification and taxation should virtually remain unused, or be utilised only in the *gravest* emergency. Certification, for merely balancing the Budget, is both unwise and uncalled for. It cuts at the root of legislative responsibility. A legislature must be compelled to bear the consequences of its own mistakes, if it is to develop a due sense of responsibility. The Government weakens this sense of responsibility by resorting to certification.

[1] This will slightly extend the interval between the execution and legislative sanction of the budget, but the adoption of the British practice will meet the situation. The additional time given for Parliamentary discussion should not, as at present, be frittered away by legislators in discussions of constitutional issues or in airing their political views. Party discipline must keep such irrelevance under check.

Public Debt.

In the field of Public Debt administration, the chief need is to *fund* the Debt. This will secure uniformity of administration, and the provision of sinking funds for the new loans. It will be a great advantage if the funding can be made with Legislative approval, as it will once for all remove the unsettling fear of repudiation. In 1921, Sir William Meyer foreshadowed the need[1] for increased borrowings in the future both by the Central Government and the Provinces. The provision of a social optimum for the population of a continent like India is possible only by big investments in development works, for which neither retrenchment nor additional taxation can supply the funds, on the scale necessary. The wealth of India must be increased before its taxable capacity can grow. Accordingly, the preservation of India's public credit is an obligation of both the Government and of the political parties interested in India's welfare. The vast scale of the borrowing will make it important that the loans should be raised with the utmost economy. A financial department is not always the best agency for such a purpose. There have been instances in which the same sources have been tapped by both Central and Provincial borrowing. Other countries have their National Debt Commissions. An organisation like the Australian Loan Council, which controls all Federal and State borrowings, both internal and external, is necessary for India.[2] A concerted loan policy is vital. The operations of the proposed Loan Council are expected to increase the public credit, conduct loan operations with the least disturbance to the money market, utilise timely occasions for

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[1] See his evidence before the Acworth Committee.

[2] H. L. Dubey, *Indian Public Debt*, p. 340; B. P. Adarkar, *Federal Finance*, pp. 276-282.

borrowing or repayment, prevent the raising of rates owing to competition, and secure the re-examination of loan programmes and the provision of sinking funds for all the loans created by it. The suggestion of the Federal Finance Committee[1] for entrusting the work to the Inter-State Council, which it has proposed for the purpose of securing co-ordination in certain fields of administration, is not satisfactory. The Committee would empower the new Council to get *expert* advice. What is needed is a permanent body of experts, and not a mere gathering of Provincial and Central interests, like the proposed Committee.

The consolidation of the Public Debt of India, and the vesting of the power to borrow in only the Central Government, and making it obligatory for Provinces and States to approach the Central Government for the loans which they might require, have been suggested in the interests of uniformity and economy. The ground for the suggestions is that the public credit is a national asset and must therefore be Federal. The suggestion however overlooks practical difficulties. It is more feasible in a unitary than in a federal State. It cuts at the root of Provincial autonomy. The power to sanction implies the duty to accept responsibility. It is true that in popular Governments, as Lord Bryce has pointed out,[2] there is always a tendency to please the present generation at the expense of posterity, and one way of doing so is to borrow in order to avoid unpopular taxation. The right of the Federal Government to enquire into the purposes of a loan may, in such circumstances, appear beneficial, but intervention in the internal administration of a province or Federal unit must undermine the sense of local responsibility. The

1 *Report*, para. 118.

2 *Modern Democracy*, ed. 1929, II, p. 320.

Percy Committee's suggestion for the constitution of a Federal Loan Fund, from which the demands of the units may be met, shifts the position of the Central Government from that of a Federal authority to that of a banker, who is entitled to know the general purposes of a loan. The Loan Council will obviate both the risks and the unpleasantness of the alternative schemes, as its members will have the insight into the purpose of the loans which the Provinces or Federal units wish to raise, without having to insist on formal disclosures, which are often disliked by those called on to make them.

Advising on the due proportions to be maintained between the external and the internal debt of India will be a useful function of a Loan Council. The lack of such an adjustment is now felt. For instance, if the sterling obligations of India are increased, they will bring in political disadvantages, diminish the demand for Rupee loans and increase the chances of losses (or gains) on remittances. Conversely, an increase in the Rupee part of the Public Debt may be advantageous. The owners of such scrip acquire an increased interest in the stability of their Government. But, the confidence and co-operation which a Government requires to enable it to carry out successfully considered plans for improving the Nation's finances and securing the amelioration of the condition of the people, are best achieved by broadening the bases of the Government and increasing its responsiveness to public opinion.

VI.

RECONSTRUCTION.

The Problem: Readjustment.

The problem of financial reconstruction in India is bound up with a number of specific issues, which have to be considered both separately and together. National income is the reservoir from which the State must draw its resources. The growth of national income depends on both the reduction of inequality and the lightening of the burden of taxation. The modern outlook in Finance has led to the recognition of the function of taxation in economic readjustment. The declared purpose for which the Indian Taxation Enquiry Committee was appointed was not merely to explore the scope for additional sources of taxation but to investigate the effects of the existing distribution of taxation among the different classes of the population. By the declaration the Government of India stands committed to a more equitable distribution as the result of the enquiry. The Report of the Committee, however, was virtually shelved.[1] This may be explained as due to the political situation; but it cannot excuse the failure of the Government to act upon its declared conviction, and review the fiscal position comprehensively.

Readjustment in taxation is but a means to an end. It aims at the reduction of economic friction, which

[1] Shelved the Report was. The argument that it was not, because occasional references have been made to the recommendations contained in it when fiscal changes have been subsequently attempted, is more plausible than convincing. That even the right wing of the popular side in the Legislative Assembly agreed to the ignoring of the Report was due to the reluctance to place additional resources in the hands of a bureaucratic Government, which might be dissipated in an increase of salaries or military charges, or the avoidance of retrenchment.

prevents the full utilisation of the productive powers of all sections of the community. It is thus, in a sense, a corollary of Adam Smith's famous 'canon of economy'.

Equity in Taxation.

The financial system and ideals of a country reflect its social conditions and outlook. To-day, there is agreement among civilised nations on the fundamentals of financial policy. The vague conception of 'Justice in Taxation' is now made concrete. Equality, in the sense of an equal marginal sacrifice on the part of all classes of taxpayers is the present-day ideal. In estimating sacrifice, the psychological factor emerges. The greatness of a sacrifice is estimated by the intensity of the feeling generated in the person who makes it. The conception of sacrifice leads to the questions of the balance between taxation and expenditure, and their relation to the inequalities of wealth and income. The principle of progression in taxation is now a recognised engine for securing fiscal equality. Since *all* taxes cannot be made progressive, it becomes necessary to adopt a mixture of some, which allow of progression, and others which do not, so as to secure a due balance between the sacrifices of the different sections of the community. Generally, the effect of 'direct' taxation on property and income, when the principle of progression is applied, is to press less heavily on the poorer. Indirect taxation has usually the contrary effect, because it falls mostly on articles of common consumption. The effect of indirect taxation is therefore generally degressive.

Regressiveness of Indian Taxation.

The larger the proportion of the public revenue contributed by indirect taxes on consumption, the greater

is the likelihood of an inequitable regression.[1] In modern schemes of taxation, direct taxation is preferred to indirect. In Great Britain, this principle has resulted in keeping the proportions of the two fairly steady, with a tendency to a slow reduction in the amount of indirect taxation.[2] In this respect, the Indian tax system affords a striking contrast to the British. The revenue from Excise and Customs now forms about 54 per cent. of the aggregate, while in England it is only 40 per cent. The direct taxes account in India for only about a fifth of the total revenue, whereas in England they account for about 60 per cent. of it. Land revenue is not brought in for this comparison. But, even if it is viewed as a direct tax, the aggregate proportion of direct taxation in India will be less than one-half of the total. If the effects of taxes on consumption are considered, it will be found that the taxes on the necessaries of life and the means of production in India and Great Britain respectively, treated as percentages of the total tax revenue, are roughly 30 per cent. and 5·6 per cent. of the total tax revenue. In India, a considerable proportion of the Land revenue is paid by persons who have not to pay an Income-tax. The burden of Land revenue must accordingly be also regarded as falling more heavily on the poor than on the affluent. Import duties in India tax not only articles of ordinary consumption, but the means of production also, and so trench upon business capital instead of business enterprise.[3]

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[1] Sir Josiah Stamp, *Current Problems in Finance and Government*, Ch. X.

[2] See Table in Colin Clark, *National Income*, 1921-31, 1932, p. 81.

[3] Alfred Marshall, *Memorandum on Fiscal Policy of International Trade*, para. 71; *Report of the Indian Taxation Enquiry Committee*, pp. 337-350.

Its pressure on the Poor.

The Indian tax system now presses with severity upon many persons who live on the margin of subsistence, and upon many others whose income is below the margin. It handicaps unprotected exporting industries, which have to compete with foreign imports. Its effects are on the whole regressive. It violates also the principle of Equity. It depresses still further the economically weak elements of society. It increases the cost of production and weakens exporting industries. Since the introduction of partially protective tariffs, the taxation falls more heavily on agriculture than on industry. Protective import duties on articles, which are both imported and locally produced, will be viewed by the economist as constituting a subsidy to the local manufacturer, the benefit of which may not generally be passed on to the consumers. The masses will thus be regarded as taxed for the benefit of the capitalist.[1]

Compensatory Factors.

The consideration of the justice of the general total weight of taxes on different sections of the community in India leads to that of the compensation due to those who are now most burdened, and to the discovery of forms of public expenditure which will raise their economic condition. The different ways of utilising public expenditure for the benefit of the community as a whole, and particularly of the sections which have suffered from regressive taxation, must therefore be examined before any scheme of Financial Reconstruction can be formulated. This is why we had to consider the optimum of expenditure in relation to the optimum of taxation.

[1] On Protection, economists and politicians are bound to differ,

Need for Planned Finance.

Economic Planning is the essential pre-requisite to the success of schemes aiming at this fiscal balance. Planning, which seeks an increase of national efficiency, must comprehend and co-ordinate schemes of educational, sanitary, agricultural, industrial and transport development. The scope for advance in each of these directions in India has been separately investigated by expert bodies constituted by the Government, and in some cases, the Government has outlined policies for the departments concerned. But the schemes have not been considered in relation to one another, and as elements of a comprehensive Development Plan. We have in India many economic policies, but no policy. We know what is desirable and possible in individual lines, but we do not know how they will react on one another.[1]

Modern Indian Tariff Policy.

A conspicuous illustration of the bad effects of the present method of considering Development Schemes separately, and not in their relation to one another *and* to National Finance, is furnished by the evolution of the present Tariff policy. After having remained a Free Trade country for generations, India is now committed to Protection. The Indian Fiscal Commission of 1921 recommended a system of *"Discriminating Protection"*, and outlined the principles on which it should be based. The recommendation was accepted by the Government of India in 1923, and an Indian Tariff Board was appointed in 1924 to implement the new policy. Since then, *seven* industries of India, of which Cotton, Steel and Sugar are the principal, have received protection. It has been maintained that the results have not been

[1] *See* H. R. Soni, *Indian Industry and its Problems,* Vol. I, 1932, p. 431, on the necessity for such action.

such as to support the arguments put forward by the Indian Fiscal Commission. The Commission had contended that the need of India was the conquest of the excessive addiction of virtually the entire population to agriculture by industrial development on a vast scale, under a protective wall of import duties. The Commission therefore envisaged a *rapid* industrialisation of the country as well as an increased demand for labour, higher wages, both in towns and on the country side, accumulation of capital, and the discovery of opportunities and outlets for the due exercise of faculties, which form the foundation of a vigorous national character.

These hopes do not appear so far to have been realised. It is difficult to see how they could have been attained by pursuing the policy which was laid down. The Indian population is indeed predominantly agricultural, only about one-ninth of it being engaged in industries, large and small. The rate of annual growth in population has been steadily increasing. In the last census period, it was 3·25 millions a year for the whole of India. The average number of persons daily employed in *large* scale industry was as small as 1·68 millions in 1928, and it cannot be much larger now. Accordingly, even on the extravagant hope of a doubling of the industrial production in the current decade, the additional employment which may thereby be created will be unable to absorb more than 2 per cent. of the agricultural labour,[1] and the remainder must continue, as at present, a burden on the land, and seek relief only through the development of subsidiary cottage industries. The utility of industrialisation will therefore consist *less* in the reduction of the pressure

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[1] Hirendralal Dey, *Indian Tariff Problem,* 1933, p. 30.

upon land, than in a *possible* increase to national wealth and taxable capacity, through an increase in the profits of expanding large-scale industries. The principal aim of the Fiscal Commission in proposing Protection, *viz.*, the rapid industrialisation of the country, does not appear realisable except in a plan of co-ordinated national development. The consideration of the chief protected industries would appear to support this conclusion, though emphasis is laid by the advocates of protection on disturbing factors, neutralising the beneficial operations of the tariff

Cotton Textile Industry.

During the period 1922-23 to 1928-29 the supply of Cotton piecegoods from handlooms was about two-thirds of that of the mills, and the handloom industry employed fourteen times as many persons as the mills.[1] The advocates of protection, who have endeavoured to focus public attention on protecting the Indian mills, have hardly realized the difficulties as well as the importance of the large body of handloom weavers. The improvement of handloom weaving calls for more education, for increased facilities for the purchase of raw material and the disposal of finished products, for suitable co-ordination and supervision and for greater adjustability to market conditions. Protective import duties cannot help the handloom weaver, as hand-woven and foreign cotton goods do not directly compete with each other. His difficulties are economic. He is in the grip of the money-lender, who acts both as the capitalist and the middleman, and intercepts all profits.[2]

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[1] See the tables in Hirendralal Dey's *Indian Tariff Problem*, pp. 87-88. The Cotton Mills employ 370,000 persons, and the handloom weavers number 5 millions.

[2] *Ibid.*, p. 90. Dividing the net gain from the duty between mill-owners and handloom weavers in the proportion of 3 : 2, the share of

The total burden placed on the consumers during this period, by the cotton-duties, has been estimated at 15 crores a year, an amount nearly equal to the proceeds of the Indian Income-tax. Of this amount, over 9 crores may be regarded as a subsidy to the Indian mills. Even with protection, the Indian cotton mills in India are in an unsatisfactory position. On the one side this is attributed to the inadequacy of the measure of protection given. On the other side, it is contended that the real causes of the weakness of the Indian mills and of their inability to withstand foreign competition are different. A great many mills, both in Bombay and up-country, it is alleged, now suffer from incompetence in management, over-capitalisation, payment of extravagant dividends (at least in the past), use of obsolete methods and obsolescent machinery, adherence to inelastic wage-rates which generate grave labour unrest, and a defective 'managing agency' system. The financial difficulties of some Indian mills are said to be due less to competition with the more efficient mills within the country than to the lowness of the tariff. Protection, it is contended, has only stabilised or accentuated the old weaknesses of the mills, and has done so by an increase of the burden on the Indian taxpayer. It is also maintained that but for protection, the Indian textile industry would have been compelled to resort to rationalisation, to reform itself, to remove glaring defects and to substitute efficient organisation.[1]

the former amounts to 4·65 crores. Mr. A. S. Pearse, *Cotton Industry of India*, Manchester, 1930, estimated the paid-up capital of the Indian Cotton Mill Industry at 41·6 crores in August 1929. The Indian consumer apparently paid by his higher prices over 11 per cent. on the paid-up capital of the Indian Cotton Mills.

[1] It is difficult in a general scheme of protection to discriminate between efficient mills and inefficient. The former do not need protection and the latter will have no inducement to improve under it. Protection is seldom a cure for incompetence and indolence.

The Steel Industry.

The protection given to Indian steel has evoked sharp criticism as well as vehement defence. Both may be traced to one circumstance, *viz.,* that Indian steel production is dominated by a single concern, *viz.,* the Iron and Steel Works of Jamshedpur on which has fallen the responsibility of pioneering so vital a key-industry, for which the natural advantages present to the country should have given exceptional facilities, if the business had been started simultaneously or with the same initial advantages as similar concerns in the West. In defence of the protection given to Indian steel, it is argued, that without it, Indian steel cannot continue to be manufactured[1] in the face of the competition of the colossal interests in steel in Europe and America. Industrialisation depends on the availability of cheap steel of good quality. Steel is the basis of all industries, such as transport, mining and textiles, and even agriculture. The production in India is now small when compared with her population, needs and potentialities. It now amounts only to half a million tons, and the imports of steel amount to another million tons. Russia[2] has wisely recognised the importance of steel

[1] "Government aid is still necessary, *i.e.,* if the production of steel is to continue" (Vera Anstey, *Economic Development of India,* 1929, p. 254).

[2] "Only heavy industry is capable of reconstructing industry, as a whole, and transport and agriculture, and of putting them on their feet." (Stalin in January 1934.) "The salvation of Russia lies not only in the good harvest of peasant farms—that is not enough—and not only in the good state of light industry, which provides the peasants with articles of consumption—that too is not enough, we must also have heavy industry . . . . Unless we have heavy industry, we cannot build up any industry, and without it we shall perish as an independent country . . . . Heavy industries need State subsidies. If we are not able to find them, then we as a civilised State will perish" [cited by Sir M. Visvesvaraya (*Planned Economy for India,* 1934, pp. 335-6), who has himself been responsible for the Bhadravati Iron and Steel Works of the Mysore State].

for her development, and a cardinal aim of the Five Year Plan has been to increase her annual output of Steel to 17 million tons by 1937. Unless the heavy industries (Iron and Steel) are rapidly developed in India, it will be impossible to carry out such things as the manufacture of the locomotives, rolling stock, plant and structural steel required for Indian Railways, the mechanical transport for the Army and tractors for rationalised agriculture.

Since the passing of the Steel Industry Protection Act (1924), which imposed duties averaging about 33 per cent. *ad valorem* on imported iron and steel goods and granted bounties for the Indian production of steel rails, fish-plates and railway waggons, there has been a continuous demand for further protection, which has been supported by the press. The inability of the Tatas' to compete with imports was due to increased cost of production in India,[1] and the low price of steel imports. The latter was rendered possible by a sudden fall in the world demand for steel, simultaneously with an increase in steel-making capacity, compelling European concerns to get rid of the stocks they had accumulated during the War at extremely low prices. It was also helped by a rise in the sterling value of the rupee (1924) from 16*d.* to 18*d.*, which enabled imports to be sold at a lower rupee price.

The critics of these protective measures have argued that the financial difficulties of the principal concerns engaged in the production of Indian steel have sprung mainly from errors of judgment and organisation, and from having started operations on a gigantic scale with management not equipped with the requisite knowledge of up-to-date steel manufacture. The initial ex-

[1] *Vide* Vera Anstey, *op. cit.* p. 250.

penses of the 'Tatas' have been heavy owing to the employment of imported technicians. Their company was undoubtedly over capitalised. The adoption of the Managing Agency system, by depriving the shareholders of any effective voice in the management of the Company and promoting differences between the shareholders and Directors, has also to be specified as a defect. A recent critic, who has summed up with ability the case against the protection to the Indian Steel industry, has characterised it as "veritably the prize boy of the Government of India", and has drawn attention to the investigation of the claims for protection by this industry on six occasions in a period of seven years, and the extension of protection for another term of seven years down to 1941. A study of the controversy may justify the following conclusions: firstly, whatever its mistakes of omission and commission, steel production in India has needed protection mainly through circumstances of a world character, and of changes therein which could not have been anticipated; secondly, that it furnishes an illustration of the old complaint that to remove protection once granted is very difficult, what originated as a concession coming to be viewed as a claim; thirdly, that on political grounds as well as in the interests of economic planning, a case can even now be made out for saving this industry, whose hopes of being able to stand on its own legs are said to be brightening.[1]

Indian Sugar Industry.

In regard to the Indian Sugar Industry, it is doubtful whether a Protective tariff is the most effec-

[1] See for the history of Iron and Steel industry, Vera Anstey, *op. cit.*, pp. 242-254 and H. L. Dey, *Indian Tariff Problem* (1933), pp. 228-231.

tive or the most expeditious instrument for its advancement. Opinion is gaining ground that by guiding, controlling and co-ordinating extensive and continuous research in cane cultivation and sugar processes, as in Java and Hawaii, and by proper re-organisation the Indian sugar industry will be enabled to stand on its own legs sooner and with more assurance than it can do with Protection and without such rationalisation.[1] If Indian sugar is to compete successfully with imported sugar, without a protective tariff, the reduction of the cost of sugar cane is even more important than rationalised manufacture.

Industrialisation.

A certain degree of industrialisation is necessary for a well-rounded economic structure. But, to industrialise India on a large scale is not *immediately* practical politics, though it is the national ideal—the dream and ambition of patriotic Indians. Many things have to be done before India's industrialisation can be well-started. Mere manipulation of Customs duties will not accomplish it, as some protectionists imagine. The first step in securing industrial progress is *Rationalisation.*[2] The present defects and difficulties of our

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[1] See Dey, *op. cit.*, 240-242, 267-270 and 275-282. The imposition of the recent excise reduces the degree of protection given to Indian sugar, and is obviously for revenue only.

[2] L. Urwick, *Meaning of Rationalisation,* 1929; Sir M. Visvesvaraya, *op. cit.,* p. 101 gives a definition of Rationalisation. See also *Economic Journal,* 1927, pp. 521-550 and 1930, pp. 551-567 and *Social Aspects of Rationalisation* (I.L.O., 1931).

The term was first popularised in Germany, where it was advocated by Walter Rathenau. The study of scientific management and industrial fatigue, chiefly in America (by Henry Ford and F. W. Taylor), furthered rationalisation. In post-War Germany, it has aimed at cutting costs and raising prices. Technical rationalisation is different from the economic and financial. Rationalized production may be financially a failure, when obsolescent machinery works more cheaply. Prof. M. J. Bonn lays down as conditions of sound social rationalization the follow-

large-scale industries are often the consequences of their haphazard growth. In their case, rationalisation will imply the substitution of deliberate planning and research for the anarchy and ignorance which now prevail. Within a factory, it will accomplish what Planning aims to do for a whole industry or for an entire community. But, the implication of rationalisation is the employment of more efficient methods of production in place of the less. This substitution will, at least for a time, result in a reduced demand for labour. The immediate effect of industrialisation on up-to-date lines cannot therefore lead, as the Indian Fiscal Commission thought it would, to an *increased* demand for labour, and to the absorption by industry of a considerable proportion of the growing population.[1]

Indirect Effects of Customs.

Customs duties, which are designed to protect particular industries, may injure the masses in various ways. Suppose only some industries secure protection, and others do not. In the case of many protected industries, the profits will come from the pockets of the general consumer, and accordingly represent a transfer of a portion of the income of the poorer to the richer classes. The effect of such protection will be to accentuate existing inequalities of distribution. Those industries and trades, which do not get protection, will be handicapped by the rise in their working costs, owing to the increase of the cost of living. The cultivator may have to pay more for the protected articles he buys, while he cannot get as much as before for the articles

ing: it must not cut into the profits of the entrepreneur; it must lower prices to consumers; it must increase wages; and it must absorb the labour thrown out by its own application (*Encyclopaedia of Social Sciences,* XIII, 1934, pp. 117-120).

[1] The reduction of unemployment and the increase of the scope for employment are among the classical aims of Protection.

he sells, because of the restriction of his markets, consequent on the restriction of imports.[1] Protection may thus exercise a depressing effect on agricultural and exporting industries. This is an aspect which should not be missed in any scheme of Public Finance, which includes a protective tariff. An ordinary *revenue* tariff, of a non-protective character, will need to be considered only from the standpoint of its effects upon standards of life.

Protection and Nationalism.

Tariff Policy is only one of several illustrations, which may be furnished, of the economic loss which may result from unco-ordinated policies in a regime of No-Plan. Effective Planning is not dependent, as is sometimes supposed, on 'Protection'. To succeed, Protection must be part of a Plan.

Protection as Policy.

Patriotism now, as formerly, upholds the faith in protection, whose close relation to the feeling of nationality, is largely responsible for its vogue in the post-War age of soaring nationalism and revived imperialistic ambitions, induced by the ever present feeling of insecurity and fear of another war. In India, the advocate of Free Trade is now suspect, and has to be on the defensive. Economists, as such, can hardly enter on considerations not germane to their science, nor endeavour to balance political against fiscal advantages, nor evaluate the economic cost of the sacrifice of autonomy. It is open to argument that the cry for protection in India will be sensibly weakened, if she gains the right of self-determination with full liberty to lay down her fiscal policy and plans of economic development and the

[1] Through the action of the Quota system.

power to circumvent the attempts of external capital and enterprise to take shelter behind a protectionist wall.

An Alternative to Protection.

Even under Free Trade, with a mere Revenue Tariff, India could have all the desired industrial development she wants, provided the assistance of the Government to industry took the form of "information, advice, loan of capital and suitable legislation". The policy of the Government of India before protection came in, and since the beginning of the century, was in accord with this view. The Government appointed Committees to enquire into both special and general questions concerning industry (*e.g.*, the Coal Fields Committee), opened special research institutes (such as the Silk Institute at Bhagalpur, 1921; the Forest Institute at Dehra Dun, 1921; and the Calcutta Research Tannery, 1919), subsidised private organisations engaged in industrial research, and imparted technological training through special institutions (*e.g.*, Sericulture at Bhagalpur; Mining at Dhanbad, 1926; Tanning in Calcutta; Metallurgy at Jamshedpur). The Government of India has provided valuable intelligence to industry and trade through special publications and agencies. India's principal deficiency in this direction has been in the want of statistical information regarding the economic position of agriculture, trade and industry, which a comprehensive Economic Survey, would have gathered and furnished. Such a survey was proposed in 1925 by the Indian Economic Enquiry Committee of which Sir M. Visvesvaraya was the Chairman.[1] The World Economic Conference of 1927 suggested an Economic Intelligence Service.[2] The

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[1] See its *Report*, Ch. VII and VIII.

[2] *Final Report* (League of Nations), p. 40 f.

proposals have been revived by the experts (Prof. Bowley and Mr. D. Robertson) recently invited by the Government to inquire into the question. If the Government also continues its successful pioneering work and demonstration in industries, like hollow-ware aluminium (1896-1903) chrome-tanning, printer's ink (1925), fish-canning (1924) and soap-making (which have all been successfully started in Madras Presidency) and it does so, not spasmodically, but as part of a plan and a time-table, it will open up profitable avenues for private enterprise and capital, or for the creation of State-owned industrial concerns, from which the Government can derive a progressive revenue. The process of industrial development by such means will naturally be slow, but the ground gained will not be lost, and the cost will be kept well within the means of the country.

Mass Education.[1]

It is the purpose of Planned Economy to balance the calls for development of different kinds, according to their basic utility, urgency and productivity. Such considerations will give precedence to the financing and execution of schemes for the removal of illiteracy and disease, over those which appear to increase productive capacity in a more direct or tangible way. As between priority schemes, the obligation to extend education is entitled to the first place, because it is more fundamental. In India to-day, all economic and social disabilities can be traced back to the educational backwardness of the masses. The impediments to industrialisation, to a more economic redistribution of the population, and to the conquest of disease and physical suffering are due to social and psychic factors, which only

[1] For the results of the Soviet attempts in mass education, see *Encyclopaedia of Sciences*, IX, p. 521.

the spread of education among the masses can control or correct.[1] The idea of the education of the masses as a primary duty of the State was recognised only about 1870 in Great Britain, when the first Education Act laid the foundations of universal primary education in England. In 1910 the Government of India opposed Mr. Gokhale's Elementary Education Bill. In 1917 a resolution for a grant of 30 lakhs of rupees for Primary education was, as already explained,[2] opposed by the Government. Education has now become a provincial subject, and is under Ministers who have no command of adequate resources. To-day, the task of overcoming illiteracy is truly stupendous. The Census of 1931 estimated the number of illiterate *adults, i.e.,* persons over 20 years of age, at over 159 millions. Of the 86 millions of children of school-going age (*i.e.,* 5 to 15 years of age) less than 5 millions could read or write. Illiteracy is far greater among females than among males. The impulse to mass education in England was given by the movement towards electoral reform, begun by the Reform Act of 1832. In India also, franchise and education are closely connected. But, with a curious change of emphasis, it is held in India that democracy postulates an educated people, and that illiteracy must be overcome *before* any advance to self-government can be made. Even apart from the attempt to make the advancement of education a condition of political progress, the cultural influences of the modern world, the pressure of international competition, and the growing spirit of social duty are compelling our

1 "Want of education is at the bottom of most of the evils which affect society, and it cannot be claimed for the Government that their efforts in the field of education have been directed by any wholehearted and strenuous determination to conquer the wilderness of ignorance on any scale commensurate with the irresistible powers enjoyed by them." Sir P. S. Sivaswami Aiyar, *Indian Constitutional Problems,* 1928, p. 346.

2 *Vide Supra,* Lecture I, p. 35.

leaders to recognise the paramount importance of mass education. Universal literacy is now part of the political creed of the Nationalist. Education is viewed both as an end in itself, and as the means to ends. It is realised that disease and illiteracy are related, and that education, even elementary, is necessary for the conquest of preventible disease.

The obstacles to the quick extinction of mass illiteracy, of such colossal dimensions, are chiefly financial and administrative. Skilled teachers are needed for an organised "drive", against illiteracy. They are not available in any thing approaching even a respectable fraction of the number required for the purpose. Nor will they be till social reform emancipates Indian women, and makes an adequate number of women teachers available for our primary schools. In 1931, *all* the teachers in India were less than half a million, *i.e.*, there was only *one* teacher for every 735 persons. But education, as it spreads, will create the instrument for its further advance. The first obligation of our Welfare Finance will therefore lie in securing an adequate contribution for education. The consideration of the ways and means for overcoming illiteracy will necessitate, in the first instance, detailed and comprehensive educational surveys, area by area, to ascertain the scope and cost of overcoming illiteracy,[1] and after a consideration of the results of the surveys, a plan for the extension of elementary education, spread over a convenient period of time. In the formulation of such plans, the questions of the allocation of the responsibility for execution and finance are not of the same order of urgency as the preparation of the schemes themselves. The average annual cost of educating a pupil

[1] Such surveys have been made and published in the State of Mysore.

in a primary school, may, on the basis of available estimates, be put down at about Rs. 7 a pupil, and that of a secondary school pupil at five times this figure.[1] Primary education and Secondary education now account for roughly 30 per cent. each of the aggregate expenditure on Education. As there are now 80 millions of illiterate boys and girls of school-going age (between 5 and 15 years of age), the plans for the reduction of illiteracy must be made progressive, and be limited by urgency, on the one side, and on the other by the extent of financial backing available.

The advance of sanitation and industrialisation must be regulated so as to take full advantage of the spread of literacy, in order that suitable co-ordination of effort, agency and expenditure, may be secured in all three.

Power Development.

What education is to the conquest of mental and material backwardness generally, are Power development and Communications to our industrial regeneration. Some of the earliest calls for big expenditure on Capital works to aid production will come from these. In an economy like ours, which is based on Individualism and Capitalism, there will be scope for the provision of future power supplies by private agencies treated as providers of public utilities.

Twenty Year Plan.[2]

The most urgent need of India is a clear vision of what has to be done for national economic and social

[1] The figures for 1931-32 work up to Rs. 7-4-0 a year for a boy in a Primary School and Rs. 7-9-0 for a girl; and the cost of secondary education per pupil to Rs. 36 a year. *Statistical Abstract for British India,* 11th issue, 1934. The figures in the text are from the older data used by the Hartog Committee.

[2] Every Plan must aim at achieving its objects within a specified period. How long should this period be? Soviet Russia started with

development during the next twenty years, and the formation of Plans to enable the programme to be carried out without interruption. The preparation of such plans necessitates the establishment and maintenance of organisations composed of technical experts, administrators and financiers. In each main field of activity, like Education, Communication, Transport, Agriculture and Industry, there should be separate planning bodies, with a preponderance of experts, to make exhaustive surveys of the conditions and potentialities of their respective areas and prepare schemes of orderly development. It will be the work of the Central Planning Organisation to co-ordinate and balance the proposals of the different Planning Committees, and formulate a National Plan. Expert bodies like the proposed Economic Advisory Council, Economic Intelligence Bureau, the Tariff Board and the Council, of National Debt and Investments, should function concurrently, and be available for consultation by the Planning bodies. Statistics should be standardised and organised. The qualities which are most required for efficient Planning are expert knowledge and disinterestedness. The whole country should be treated

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a five-year term and has had to extend it for another five years. Sir M. Visvesvaraya favours a *ten*-year term for Planning for India. But, as he has himself admitted, 'it would take at least two decades for India to build up a *per capita* income comparable to that of the least progressive of the Western countries' (*Planned Economy for India,* 1934, p. 240) ; the vested interests of foreigners in India cannot be extinguished even by compensation in less than fifteen years (*Ibid.,* p. 231), and a couple of decades will be required for India to reach the stage at which the further use of machinery will reduce employment (p. 245). The Indianization of the Army, which is a fiscal aim of the plan, will need about fifteen years (p. 343). The preliminary economic survey will need at least three years (p. 366) and the collection of the requisite data and creation of planning machinery will need time. A long-term plan will be more elastic and afford the opportunity to correct initial errors in calculation or administration. The degree of backwardness in India is also so great that a *decade* will be inadequate for a plan to overcome it.

as a unit for the purpose of Planning. The execution of Plans may be entrusted to Provincial, Local and State agencies, but their formulation and the ultimate responsibility for their finance and supervision must be in the hands of a Central body. Planning must be centralised. It must also be rationalised, even as industries are, and proceed *pari passu* with the rationalisation of Production and Distribution. The necessary organisation should have permanence and reasonable freedom. They should be above the suspicion of being influenced by class considerations or political interests.[1] Can such leadership be secured? Can such a board of super-planners 'with a capacity for foresight and appraisal beyond all human experience' be formed by selection or popular election, and when appointed be immune from temptation, error and failure? Herein lie the chief obstacles to successful planning.[2]

The Legislative and wide public support, which they require, must be based even more on the reputation of their members for integrity and special knowledge than on their constitution by the votes of Legislatures. Modern experience of Planning, whether in a Federal or in a Corporative State, shows that the vital needs of 'National Recovery Measures' justify the unity of aim and control represented by an economic dictatorship.[3] The establishment of Planning organisation must be preceded by effective reorganisation of the satistical

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[1] *Cf.* Gustav Cassel: "Believers in planned economy usually simplify the question by assuming that such an economy should be under the leadership of absolute knowledge and reason, and thereby be raised above the petty troubles of the old social order" (Cobden Lecture, 1934, p. 17).

[2] See 'the *Round Table*', 1933, pp. 765-767.

[3] "Planned economy will always tend to develop into dictatorship". "Economic dictatorship is much more serious than people believe. Once authoritative control has been established it will not be always possible to limit it to the economic domain". (Gustav Cassel, *op. cit.*, pp. 25-6).

organisations of the Government, so as to provide for the collection and the preservation of the data needed for the formulation of complete schemes. The absence of such information in India, in spite of all that Government has done and is doing, has been frequently commented on. To postpone the creation of what may be regarded as the key-industry of economic planning, on such a ground as the large expenditure involved, will not be wise economy.

How to Finance Plans.

The preparation of even approximate estimates of the costs of "Big Deals" is rendered very difficult by two circumstances, *viz.,* (1) the want of quantitative data based on accurate statistics, to show the amount of work to be done under each class of development, and (2) the force of circumstances which renders it necessary to spread out the execution of Plans in India over a large number of years. India has not the resources in men and money to attempt the "hustling" programmes, which are being tried in Soviet Russia and the United States of America.[1] Her schemes will have to be financed either by additional taxation, though the taxation already weighs heavily on the poor, or by loans, which will also add to the tax burden.

An inconsiderate addition to the number or the rigour of existing taxes, may diminish the ability and the desire to work and to save, and accentuate existing inequalities by the diversion of resources from employment to employment. Not only should wise planning therefore aim at avoiding such consequences, but it must deliberately include the provision for an annual increase in the national capital, 'by a rational division of income between saving and consumption'.[2]

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[1] Hugh Dalton—*Public Finance,* p. 127.
[2] Gustav Cassel, *op. cit.,* p. 19.

Nationalisation or Monopoly?

The pressure of necessity has driven modern opinion to look for sources of Public Revenue outside Taxation, and to go back to mediæval methods. An expanding revenue derived from the profits of great industrial undertakings, owned and managed by the State or from Government Monopolies, is recommended for the State of the future, if it cannot conveniently increase its formal tax revenue. The nationalisation of mines, key-industries, banking, insurance and transport has been suggested. In regard to some of these, India is already reaping the benefits of Public Ownership (*i.e.,* Railways and the Post and Telegraph). India's forests constitute valuable public assets with great potentialities of further increase. She has a State monopoly, secured directly or indirectly, over articles of universal consumption like salt. But the income from such sources is not capable of much increase. In regard to her railways, it has been recently stated with authority, that the Depreciation Fund, which appears large, is not really so, as it is not based on a generous calculation, on a proper accounting, that will allow for both the natural life of Railway Assets and for obsolescence. The financial results of the Indian State Railways, since the separation of the Railway Budget in 1924, have not been very satisfactory. From 1927-28 the *net* traffic receipts, expressed as a percentage of the capital at charge, have been steadily falling till in 1932-33 they reached the low water-mark of 2·9 per cent.[1]

Banking.

In the present inadequacy of banking facilities in

[1] See the Article by Mr. P. R. Rau, Financial Commissioners, Indian Railways, in *Roy's Weekly,* 9th July, 1934.

India,[1] the assumption of the banker's work by the Government may be both feasible and necessary, but not as a State monopoly. Credit is sensitive. Its intimate association with a Government is not always advantageous. This principle is implicit in the constitution of India's new Reserve Bank. The Government is not to be a shareholder of the Bank, though its rupee coin to the extent of 50 crores will be transferred to it and the duty of establishing the note issue and currency will hereafter be vested in it. The Reserve Bank is to be treated as the chief expert in banking in the country, and the function of exercising control over the banking operations throughout India and over credit generally is to devolve on it. The Reserve Bank is not to be influenced by powerful vested interests or by legislative or political bodies.[2]

Insurance.

The suggestion has been made that the business of Insurance should be nationalised. This proposal has more than a fiscal aspect. Its economic and moral advantages to the insurer are obvious. The large sums accumulated from insurance premia are available for

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[1] This is shown by the low *per capita* banking deposits in British India (Rs. 6-4) when compared with the corresponding figures for Japan (Rs. 215), the United Kingdom (Rs. 698), Canada (Rs. 804) and the U. S. A. (Rs. 1,123).

[2] For a convenient summary, see the Article by Prof. G. Findlay Shirras on 'the Reserve Bank of India', in the *Economic Journal,* June 1934, pp. 258-274.

[3] *Encyclopaedia of Social Sciences,* IX, p. 472. Italy made life insurance a State monopoly in 1912 and took over the insurance business of foreign companies. In Japan Industrial Insurance is a State monopoly, which is run in conjunction with the Post Office. New Zealand employs paid agents to secure new 'business' for her State Insurance. In the U. S. A. one in every four persons is insured, as against one in five in Japan, one in ten in Great Britain and one in five hundred in India.

investment in the country, and can be used for development of industries, railways and shipping. In the United States of America over one-half of the insurance funds are invested in farm-mortgages. In India about three-fourths of such funds are held in Government securities. On the fiscal side, the direct importance of insurance companies to the State is that they contribute to the income-tax revenue. On the administrative side, the Government has to undertake some degree of control over private insurance companies, and this will in the future have to be greater, in the interests of the growing number of insurers. The Indian Post Office does a little insurance business, but its benefits are limited to public servants. There is much scope at present for improvements in the Insurance branch of Government activity, as well as for the increased supervision of private Insurance Corporations, the stiffening of the law against the growth of unsubstantial concerns, and for making insurance compulsory for all who enter the public service. If the Government of India undertakes insurance work, as more than one Indian State has done, it may be in a position to offer conveniences, which many insurance companies cannot afford, unless they can open many expensive agencies. Properly managed and developed, Government Insurance will stand against the competition of private corporations. It will bring in substantial revenue to the exchequer, and provide funds which could be utilised in sound national undertakings. But, the nationalisation of the insurance business is not immediately feasible in India. Insurance is one of the few lines of thriving private enterprise in India. The anticipated benefits of a Government monopoly of insurance can be better secured by an extension of the State Insurance activities, and the proper taxation and control of the

private corporations,[1] than by the establishment of a Government monopoly.

Mines and Minerals.

The nationalisation of mines and mineral resources stands on a different footing from that of insurance and banking.[2] The working of mines once for all diminishes the stock of irreplaceable resources. Their uneconomic exploitation and the discriminatory sale of their products are against public interest. They are now mostly worked in India by non-Indian capital and agency. It would obviously pay in the end to buy out such owners and operators and work the mines as State concerns. The chief difficulty in carrying out the idea lies in finding the huge purchase price, at a time when the redemption of the Company-owned railways is falling due, and large sums are required for various classes of more urgent welfare expenditure.

Large gains from an extension of the economic activities of the Government in these directions are not therefore likely to materialise. But, the trend of the day is to look on mines and minerals as useful and elastic sources of public income. Direct management may be relatively more remunerative, and also avoid the un-

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[1] N. Mukherji—Indian Insurance Year Book, 1932 (Official). The Indian Life Insurance Companies Act of 1912 and the Indian Insurance Companies Act of 1928 now govern them. Of the 282 companies coming under the Indian Insurance Law, 136 are constituted in India. The total *premium* income in 1931 was Rs. 8½ crores, of which Rs. 4½ crores accrued to Indian Companies. The *net* income of the latter was 5·2 crores. The Postal Insurance brings in a total income of ·81 crores, and the assurances in force under it are under 5 crores of rupees.

[2] Mining legislation has been less extensive than factory legislation in India. Except in *Janmom* lands in Malabar and some permanently settled estates, the right to all minerals found vests in the State, in India. Licenses are issued to prospectors, who have the right to demand mining leases for 30 years. The power for the Government to inspect mines was given by the Mines Act of 1901.

doubtedly more difficult task of control, which the Government has now to exercise over them.

Rationalisation of Finance.

The remaining resources for welfare finance or reconstruction are retrenchment, rationalisation of existing taxes and the imposition of new taxes. The examination of the equity of tax-exemptions, now in force or hereafter to be granted, is the counter-part of economy. The exemptions attract scrutiny when tax-handles are in consideration, for the purpose of discovering ways of improving tax efficiency. Some illustrations of the need to revise current exemptions in the Income-tax have already been noticed.[1] The exclusion of the income from agricultural land from the Income-tax schedules requires to be dealt with separately and along with it, the question of the retention of Land revenue in its present form in the Indian Fiscal System.

Tax Readjustments.

On the *debit* side, claims for release from taxation are put forward on the ground that taxes should be imposed on a person in such a way as not to trench on the minimum necessary for the upkeep of life and efficiency. It is urged that the attitude of the State towards the citizen, regarded as a potential producer, should not differ from that of a creditor in law towards a debtor. The workman's tools have always been, as in ancient India, free from distraint for debt.[2] A labourer's means of livelihood has a claim to exemption which is hardly less strong.

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[1] See *supra*, Lecture IV, p. 156.

[2] Agricultural implements cannot be distrained in British India for failure to pay the land revenue. See *Naradasmriti* (ed. J. Jolly), p. 217, and *Viramitrodaya Vyavahara*. (ed. Jibananda), p. 724.

The regressive character of the present Indian fiscal system and its inconsistencies are illustrated in the provision of a taxable minimum for the Income-tax and the denial of any such minimum for the Land tax.[1] The inconsistency has had some plausible defence. It is contended that the minimum of exemption provided for the Income-tax is fixed, because it is difficult and expensive to assess and collect the tax from a vast number of persons with small incomes.[2] The argument confounds the fiscal canon of economy with that of equity. Differential treatment violates equity. A tax which is expensive to collect violates economy. But, the discrimination between income from land and other incomes is not explained satisfactorily on this ground. Even the most minute holdings, like the uneconomic holdings in Ratnagiri, which measure 1|160 of an acre, are not now exempt from the land tax though the difficulty of collecting the land tax from a large number of small holdings is much greater than collecting an income-tax from low incomes. On grounds of justice as well as consistency, there would appear to be ground for a minimum of exemption even in the Land tax, but it will be obviously difficult to give effect to the exemption, unless agricultural income is brought within the Income-tax. Another instance of discrimination, which appears to be difficult to defend, is that of the import and excise duties on foreign and Indian kerosene, which constituted a virtual gift of about a crore to the Indian Oil industry.

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[1] A small parcel of land may form part of the wealth of a rich man. To apply the minimum principle to the rich man's lands will in such a case be inequitable.

[2] V. K. R. V. Rao, *Taxation of Income in India*, p. 146. *The Indian Taxation Committee* (*Report*, p. 196) held that this difficulty has greatly increased since the transfer of income-tax work from the ordinary district staff to the Imperial Staff. The exemption limit was Rs. 200 in 1861, became Rs. 500 in 1886, Rs. 1,000 in 1903 and Rs. 2,000 in 1913, and has again become Rs. 1,000 since 1931.

It is analogous to the withdrawal in 1926 of the Cotton Excise Duty.[1]

Indianisation.

The application of the 'axe' to the Public Services and their 'Indianisation' is expected to yield a return, which is not however estimated to exceed Rs. 2 crores. Such an amount is not to be neglected. The Federal Structure Committee upheld on fiscal grounds the retention of the tribute from Indian States, which brings in only 3|4 of a crore. The reduction of administrative cost will have a cumulative effect in diminishing pensions.

Defence Expenditure.

All plans of retrenchment in India are thrown into the background by the agitation for the reduction of the Defence Budget. Welfare functions have become permanent obligations of the modern State, and they can be effectively discharged only if the requisite funds are released by international disarmament. The authors of the "Memorandum on Public Finance 1922-26", prepared for the League of Nations[2] urged that "the fact that a large proportion of the Budget-charges are fixed, *limits* the possibility of economy to the votes of the Civil and Fighting services, *the only items which can be reduced*". This is the League of Nations way of viewing the question. Safeguarded or not by statutory provisions, the public demand for a reduction of India's Defence charges will continue and will have to be met by rigid economies, by Indianisation of the commissioned ranks and replacement of the British by Indian troops

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[1] See Gyan Chand, *Federal Finance*, pp. 226-227. Imported kerosene paid As. 2½ a gallon, and the Indian excise duty on kerosene was only 1 anna a gallon. The difference had since been reduced.

[2] 1927, p. 20.

and personnel, and reduction of the effective strength of the Army to a peace footing. The Military training of the civil population, to furnish a second line of defence, can be supported on fiscal as well as on other grounds.

The argument for the upkeep of big armaments is the ever-present risk of War. The danger is now not less than it was before the War. The new Nationalism has increased the risk by over-emphasis on national, as contrasted with international, feeling and by generating disputes over tariffs. There is a tendency in India to exaggerate such risks. India's position within the Empire gives her the protection of the British fleet. But, it has also the incidental disadvantage of bringing her within a Tariff Union, the terms of which are stated to be against the interests of the Indian masses.[2]

International Mind.

The habit of political agitation against the British domination may harden into a national trait. The remedy is responsible government. Only next to it is the cultivation of an international outlook even from the early stages of education in India. This will necessitate an alteration of the traditional methods of presenting history to young minds.[3]

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[1] Mechanization is now absorbing large sums in the Army. Apart from the reduction of the burden, it is to India's interest to demand that arms, munitions, military stores, explosives and the requisites of mechanization should be manufactured in India, as cordite now is. The cost of mechanization will be reduced when India is able to manufacture motor vehicles. The object is to increase the speed and reduce the length of the slowly moving transport column (See Ch. VII of *Indian Army Budget,* 1934).

[2] *Cf.* C. N. Vakil and M. C. Munshi, The *Ottawa Agreement between India and Great Britain,* 1932, pp. 25-26, and D. R. Gadgil, "*Imperial Preference for India,* the Ottawa Agreement examined", 1932, pp. 54-58.

[3] Speech by the Right Hon. V. S. Srinivasa Sastri.

Communalism.

Communal rivalry within the country has a fiscal reaction. It furnishes a reason[1] for the maintenance of the large British element in the Army and in the Police, and for the upkeep of both the Defence and the Police at a strength generally regarded as much in excess of the requirements of the country, and including them under the 'safeguards' in the new constitution. The frequency and gravity of communal disturbances are perhaps exaggerated. They have existed in the past and will continue in the future, and are by no means a monopoly of India. The suppression of serious rioting is a normal function of Governments, and for this duty, their Police should be adequate. In one respect disturbances in India are less serious than in many other countries, because lethal weapons and powerful explosives are not accessible to the discontented elements of the Indian population. The political argument that a relatively costly British element in the Army, in the Police and in the Civil Services is necessary owing to its impartiality in the face of communal rivalries, will have some force only if it can be maintained that such an element can itself have no interests.[2] Nevertheless, the financial effect of the communal evil is grave, and cannot be overlooked. It has led to successful agitations for communal representation in the Public Services, leading to recruitment based on considerations other than efficiency and merit.[3] The moral effect on the Public Service, both among those who are benefited by a rule of communal preference, and among those who are penalised, has its reaction on the efficiency and

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[1] Cf. *India*, 1930-31, 1932, p. 47.

[2] Sir Sivaswami Aiyar, *Indian Constitutional Problems*, p. 344.

[3] The most recent instance is the Resolution of the Government of India to reserve 25 per cent. of all appointments in the Services to Muhammadans.

integrity of the administration. Coupled with the tendency for the formation of political parties and interests on communal lines, it is apt to engender extravagance in administration, in the creation of superfluous appointments, and in the maintenance of rates of remuneration unjustified by economic consideration. The settlement of communal differences, viewed from even the narrow fiscal standpoint, is a great duty.

Non-Cooperation.

Political agitation, when it becomes widespread and chronic will have far-reaching economic effects. Intelligent agitators perceive the effects, and deliberately treat them as the price to be paid by the nation for the political advantages to accrue from the success of the agitation. The Non-Cooperation movement in India appears to furnish an apt illustration. Political demonstrations which lead to increased administrative cost, are manifestly uneconomical. They weaken confidence in the country as a field of investment, lower the price of its securities, impair the credit of its merchants engaged in foreign trade, impede the flow of external capital into it, and add to the annual charges on account of its Public Debt. These results have been illustrated by recent Indian history. A vivid consciousness of his political rights, and the patriotic urge to labour for his Motherland, are not necessarily barred to an Indian by a frank recognition of the possible economic harm flowing from frequent or long continued Non-Cooperation, which must weaken the law-abiding fibre of the citizen.

Tax Reform: New Taxes.

The exhaustion of other means leaves Tax reform as the last hope of Indian Welfare Finance. There has been no dearth of proposals for new tax handles. The

Taxation Enquiry Committee recommended the retention of the export duty on jute,[1] the imposition of an export duty on lac[2] and of an import duty on foreign salt taken into Bengal (incidentally discouraging its consumption in competition with Indian Salt),[3] a tax to restrain the hoarding of precious metals,[4] and taxes on tobacco[5] and mineral water[6] viewed as 'common' luxuries. The Committee also proposed that the Income-tax should be based both on origin and domicile,[7] and that the Super-tax in the case of Companies, should be replaced (as once recommended by Prof. Seligman) by a Corporation Profits Tax.[8] The taxation of betting and advertisements, and of unearned increments brought about by 'Betterment', 'Luxury' taxes, taxes on pilgrims,[9] and servants (as suggested by Marshall) were also recommended by the Committee. Sir Josiah Stamp has proposed a light Poll-tax[10] "as not unsuitable to the conditions of India", and the Taxation Enquiry Committee could think of no efficient alternative to a Poll-tax to deal with fugitive cultivation in the hill-tracts. The Committee considered and condemned the existing tax on sea-passengers in Burma,[11] the export duty on hides and skins,[12] and the proposals to impose a tax on adoptions, as well as a registration fee[13] on marriages

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1 *Report*, p. 128.
2 *Ibid.*, p. 130.
3 *Ibid.*, p. 143.
4 *Ibid.*, p. 153.
5 *Ibid.*, p. 362.
6 *Ibid.*, p. 154. The taxation of Patent medicines was also recommended by the Committee.
7 *Ibid.*, p. 191.
8 *Ibid.*, p. 203. This has been accepted by the *White Paper*.
9 *Ibid.*, p. 316.
10 *Ibid.*, p. 16.
11 *Ibid.*, p. 23.
12 *Ibid.*, p. 130.
13 *Ibid.*, pp. 412-416. Two of these proposals emanated from Dr. R. P. Paranjpe, a member of the Committee.

and a tax on dowries.[1]

Some of these taxation proposals are incorporated in the Scheduled Tax Rules, framed under the Government of India Act of 1920.[2] The new tax heads are now within the competence of the Provinces. One of them is the Inheritance tax (Succession Duty or duty on survivorship in a Joint-family), which was viewed with favour by the Taxation Enquiry Committee. The rates levied on places of public entertainment are usually of the *genre* of monopolist rating, and cannot ordinarily be shifted on to the consumer. Migratory troupes and shows entail expenditure on local bodies, and their taxation is accordingly justifiable. The 'Turn-over' tax, which has been a great success in Western countries, is unsuited to Indian conditions.

Among proposals to revise the *rating* of existing taxes, the most important is that to steepen the rate on the higher incomes and in the Super-tax. There is justification for this revision. A good case can be made out for the restoration of the Cotton Excise Duty purely as a revenue measure.[3]

Of the major suggestions which merit consideration from the standpoint of equity as well as productivity, the three most important are for the imposition of an Inheritance tax, a Tobacco Duty and the revision of the existing Land taxation, so as to remove the discrimination now caused by the Permanent Revenue Settlement. Of these, the duty on *Tobacco* will bring in a considerable addition to the public revenue, even if lower

[1] In some branches of the Indian Church, *e.g.*, the Syrian, and among some Indian Muhammadans, the Church and the Mosque get a percentage of the dowry. The payment has hardened into a custom, enforced by the communities concerned.

[2] Section 80-A, 3 (*a*).

[3] *Cf.* Gyan Chand, *Federal Finance*, p. 231.

rates than those which now prevail in Travancore and Cochin are adopted. Tobacco is not a necessary of life, like salt. Its use is not beneficial to health, but is spreading. The chief objection to a tobacco-tax will be the difficulty of administering the tax, so as to prevent evasion.

The Inheritance Tax.

The Inheritance tax, which fifty years ago was regarded as a fiscal novelty, is now generally used as a compensating factor in fiscal systems.[1] Its adoption in India will not altogether be an innovation, as there is already a Probate and Succession duty, which partially acts as an Inheritance tax. The value of the Inheritance tax (or Death duty as Gladstone used to call it) is that it lends itself to progression, both on the ground of amount and on the character of the expectations of the inheriting person. The Rignano Scheme is a radical device for appropriating for the State, in three generations, the entire value of an inheritance; but its sweeping character has prevented its adoption anywhere.[2] In India, the imposition of an Inheritance tax will have to take account of the sentiments attaching to property and 'joint-family'. In other countries, death is the starting point of inheritance, in *Mitakshara* Hindu Law, it is birth. The principle of survivorship has had to be introduced to make the rule applicable to Hindus. The pious obligation to perform *Sraddhas,* which goes with inheritance, is adduced as an objection, but the obligation exists even in the absence of any property to be inherited. What may be necessary if the Inheritance tax is adopted is to impose a minimum limit below which

1 *Encyclopaedia of Social Sciences,* VIII, pp. 43-44, for a description of the practice in different countries. See Appendix.

2 Sir J. Stamp and E. Rignano, *Social Significance of Death duties,* 1925.

successions will not be taxed, and apply the principle of progression steeply both as regards the value of inheritance and the remoteness of the heir. It is sometimes contended that a tax on inheritance must come only out of capital, but this is a fallacy.[1]

The Land-tax in India.

The *Indian Land-tax* is the target of modern fiscal criticism. Its incidence is extraordinarily unequal between place and place.[2] It does not conform to modern ideals in land taxation. It is neither a flat rate on capital value nor on annual value of the land, nor a progressive tax on the income from land. In most modern States the flat rate is kept low, and is supplemented by imposing on the income from land both the Income-tax and the Death duty. In view of the impossibility of shifting the burden imposed on them, by such taxation, the owners of land have to bear a heavier burden than those who derive the same amount of income from trade or industry. The methods of assessment of the Indian land-revenue are very complex. They diverge from place to place. The provincialisation of the land-revenue has brought it under influences which tend to reduce its value as a fiscal asset.

The sore point of the Indian Fiscal System is the *Permanent Revenue Settlement.* It is believed to give 12 crores of unearned income to the Zamindars of Bengal alone, and the permanently settled estates in the other provinces (Madras, Bihar and Orissa) must also

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1 E. Cannan, *Wealth,* 1928, pp. 131-133, and Josiah Wedgewood, *Economics of Inheritance,* 1929, pp. 213-214. "In Bengal even the present probate duty on a rich estate brought in 1929 a windfall of Rs. 52 lakhs. In Bihar there are estates one of which will, if subjected to an inheritance tax of even 10 per cent., yield a revenue whose amount will mean very great relief for its straitened finances". (Gyan Chand, *Federal Finance,* p. 211.)

2 C. N. Vakil, *Financial Developments in British India,* p. 390.

leave a considerable surplus in the hands of the Zamindars. The owners of land in other areas have not this privilege or advantage. Economists, influenced by socialist ideals, are unable to support an arrangement which perpetuates a fiscal inequality of so glaring a kind. The right of the State to impose taxes on the income from Zamindari estates has been declared to vest in the Government and is reserved.[1] The suggestion, which attempts to move on the lines of least resistance is that the exemption of agricultural income from the Income-tax should again be repealed. The objections to this proposal are two. (1) If land incomes are to be treated as liable to Income-tax, the small cultivators should be exempted from land-revenue. Many objections to such an exemption have been urged. Most landholders will be found to be below the exemption limit, and the land-revenue will become everywhere a vestige of the past, and in some provinces it may be wiped out. The exemption will encourage fractionisation and division of property *inter vivos,* so as to bring the land below the minimum limit. Prof. C. J. Hamilton apprehended that it would increase rural debt to the limit of the new capacity; and Prof. H. S. Jevons considered that it would encourage an increase of population. These are extreme cases of possibility. It is doubtful whether the proper corrective to either the growth of the population or of rural debt is enhanced taxation. Carried to its logical conclusion, the argument will bar the removal of any tax burden now resting

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[1] See the summary of the debate in the Supreme Legislative Council in 1860 in Pramathanath Banerjea, *History of Indian Taxation,* 1930, pp. 80-84.

The Zamindars of Bengal paid the Income-tax when it was imposed, as late as 1917, Sir W. Meyer reserved the right to tax Zamindari income. It is part of the Indian Nationalist demand to urge the extension of the Permanent Settlement principle to all other provinces, and to limit by Statute the State's demand on land.

on the person of small means. The real difficulty in the way of giving the exemption is the big fiscal loss involved. As in the case of the Salt tax, equity demands the sacrifice, but practical exigencies do not relax their hold on the tax.

The conversion of the Land-tax into an Income-tax is an alternative proposal. This has some advantages over other suggestions. If the conversion is made simultaneously with the total repeal of the Land-tax, it will automatically get rid of the legal difficulty in dealing with the Permanent Settlement. It will obviate the need for complex and costly resettlements, *jamabandy*,[1] and periodical remissions of revenue for failure of harvest or seasonal vicissitudes. It will not base the proportion of the income to be paid as a tax, on commutation rates calculated as an average of prices over a long period, during which big fluctuations have occurred. It will remove the present anomaly of divergent principles of land settlement in the same country. It will not make it more difficult for a trained staff to assess the income from land for Income-tax than for land-revenue. It will remove the artificial barrier which now divides the income from land and other kinds of income. But, three difficulties will remain, *viz.*, (1) those connected with the exemption below a limit, (2) with the impracticability of fixing a tax rate which will conform to that of ordinary incomes and at the same time not bear the same proportion as the present land-tax does to the income from land, and (3) with the separation of irrigation rates (which are now

[1] "The jamabandy or annual settlement comprises a detailed scrutiny of the village and taluq registers and accounts with the object of ascertaining whether all items of land revenue, including the demand for permanently settled estates, *inam* villages and minor *inams*, have been properly determined and brought to account." Madras Board of Revenue, *Standing Orders*, Vol. I, 1913, p. 14.

compounded with land-revenue in certain parts of India).

An alternative suggestion to tax the estimated capital value of the land,[1] has been made on the ground that it will obviate elaborate calculations of outturn, cost of production, etc., and that it will be easy to assess, as land has become a commodity and permanent lease-hold rights are already saleable. The objections to the proposal are that it overlooks the speculative element in the sale of land, the social motives enhancing the market value of land, and the possibilities of fraud by a collusion between buyer and seller to conceal the real price. It will also give a wide discretion to the assessing authority, which may not be wisely exercised.

The Financial Ideal: Its aspects.

The stage has now been reached at which it is possible, in the light of the considerations already urged, to outline the financial ideal for India. Unity and continuity should be the outstanding features of our future system of Finance. Its integrity should be violated neither by the development of Provincial autonomy nor by the advent of Federalism. A fairly long span of years (say twenty) is needed to enable Planned Development to arrive at substantial results. The prerequisites of its success are not only continuity of action but unity of purpose and control. But divided responsibility may prove an evil accompaniment of the devolution of powers and functions to local authorities. Undiminished responsibility must therefore rest on the Central Government for all the efforts to be made to attain the social optimum. The motive force of welfare movements must find their springs in the Central legislature. Education, sanitation, agricultural pro-

[1] *Indian Journal of Economics,* VII, pp. 151-3.

gress and industrial development are matters of national, and not of mere provincial concern. Their progress should be neither delayed nor impeded by any want of harmony between central and local policy and action. Since the advent of Provincial Decentralisation, such a danger has become both real and near. The devolution then introduced has been criticised as premature and disadvantageous to India. The Auxiliary (Hartog) Committee on Education to the Statutory Commission was emphatic in its condemnation of this measure. "The responsibility for mass education," contended the Committee, "rests primarily with the State, and the provision of educational facilities for all classes and communities, and for all areas should not be left entirely to the mercy of local authorities." It held the view "that the divorce of the Government of India from education has been unfortunate," and recommended "that steps should be taken to consider anew the relations of the Central Government with this subject".[1] The formation of an educated electorate is a national, and not a local obligation. So is the conservation of natural resources, national health and the efficiency of the people. It will not therefore be sufficient for the Government of India to remain in regard to such subjects merely as the source of information and advice, and to act as a "clearing house" of provincial experience. It should do more, and undertake a *direct* responsibility for all the action, which is necessary for securing amelioration and progress. The course of constitutional development in India does not make it easy to restore the relaxed authority of the Central Administration, but the recovery is necessary for the integrity and effectiveness of the movement towards the social goal. India's constitution is after

[1] *Report of the Committee,* 1929, p. 87, and p. 346.

all still in the making. Federation and Provincial autonomy are alike the gifts of central authority, and not the results of natural growth. The way to recovery lies through a readjustment of powers and duties between the centre and the units, in the interests of National Planning.

Fiscal reform in India will hereafter be coloured, and even modified much more than at present, by ethical motives, harmonizing with the trend of modern economic and social opinion. One of its chief purposes will be a readjustment of tax-burdens, so as to diminish the dead weight on the unaffluent members of Society. The full and immediate realisation of this aim will be impracticable owing to the narrow bases of our Public Income, and the inelasticity of its component elements. Obnoxious forms of revenue, like the Salt duty and the Customs and Excise on Drink and Drugs, will have to be retained, solely for the revenue they bring. It will also become necessary to add to the list of taxes on consumption by bringing under Customs and Excise, articles like tobacco and mineral waters. A direct relief to the rural population, by exempting a minimum of agricultural income, considered necessary for life and efficiency, from the scope of land-taxation will (even if feasible) have to be deferred till the consequential sacrifice of revenue is balanced by the natural growth of the income from other sources. The compensation to the poor, who now suffer from the regressive effects of the fiscal system, must therefore be found in liberal and well-designed *expenditure* aiming at an amelioration of their economic and social conditions. The balancing factor in an equitable distribution of the weight of taxation in India must accordingly come from the side of public expenditure rather than from that of public revenue.

The reduction of economic inequality, by the application of steeper progression in the higher levels of the Income-tax and the Corporation tax, and the imposition of a comprehensive Inheritance tax, which will operate on Hindu estates, through the principle of survivorship, will also indirectly reduce the existing pressure on the poor. The removal of bounties, avowed or involuntary, to industries or interests, which can or should be able to do without such help, will work in the same direction. The removal of the Cotton Excise duty conferred on the cotton industry a bounty in the same manner as the difference between the import and excise duties on kerosene did in the case of the oil industry. Every addition to the public revenue, which is not due to the taxation of articles of popular consumption, must ordinarily bring about a more equal distribution of the burdens between the rich and the poor. To this end, all possible tax-resources, such as the export duty on lac, will have to be tried, and larger revenues raised from increased activities of the State in the fields of commerce, industry and Public Utilities. The extent to which these sources can be enlarged for tapping will depend on the *minimum* calls of Public Expenditure.

The separation of the commercial from the ordinary revenue accounts will be carried out more fully in the future than at present, and each State enterprise will be so organised as not only to be able to develop itself through its own accumulating resources but to be able to make an annual contribution to the State. The financing of industrial expansion, in the case of specific undertakings, will be made from capital, raised by loans rather than from income. It may become necessary in view of the large sums to be raised to fund the Public Debt and to restrict redemptions of debt to the bare

requirements of stable credit. It will be obviously unwise to repay debts and borrow at the same time.

Future Budgets.

The budgets of the future will not be under the obligation to balance the income and expenditure of every year. Planning will stabilise certain elements of expenditure, for which financial provision will be made in advance *for a series of years.* An unbalanced budget will provoke concern only when it relates to the whole or a good part of the period envisaged by a Plan. Inability to carry the savings of a year into the next is now responsible for spasmodic, hurried, and uneconomical spending. Quinquennial grants are not unfamiliar to our commercial departments. The practice will extend to the whole budget. Big schemes involving additional taxation, borrowing and encroachment on the area of private enterprise by public owned concerns, will render Legislative approval for the items of the future budget even more necessary than at present. It will accordingly be in the interests of the nation that the principles and the details of the budget should be adequately discussed before the budgets are voted on.

The New Expenditure: Capital Items.

On the expenditure side of the budget, the *capital* items will be the large sums required for Power installations, for improvement of transport and communications, for extension of irrigation, for new school buildings, and for pioneering industries. The big amounts, which are needed, will have to be raised by *loans,* preferably in India. The extension of the State activities in Banking and Insurance may help. In the interest of the Public Credit of India and of economy, the borrowing operations will be conducted through an Investment

Board, as in Australia, and with the sanction of the Central Legislature. The loans to the Provinces will be made on the security of their assets, through the same Board and with the sanction of the Legislatures concerned, so as to avoid the evils which attend independent and promiscuous local borrowing. The nationalisation of the Railways, as well as of the Mines and Oil-wells will also be proceeded with steadily as the conditions of the loan market and the credit position enable the sums required to be borrowed economically.

Recurring Expenditure.

The chief new items of Central expenditure on industrial and commercial development will be those required for the co-ordination and expansion of the research organisations now in existence, and linking them with one another and with the Universities and technological institutes in the country. A first-rate Scientific and Industrial Research Service is vital to our industrial expansion. Within this category may be brought the expenses involved in the creation and maintenance of the permanent Planning Commission, its branches, and its auxiliaries in Statistical and Survey work. Even in England, there is now a complaint that the statistical work of the Government is not centralised, co-ordinated, and standardised, and is accordingly not as helpful as it would otherwise be.[1] An expenditure of about *five* crores a year, under Central control, available for distribution to the Provinces, will be needed to secure for India the scientific and technical advice, which her Government and private entrepreneurs now lack and which are essential.[2]

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[1] Colin Clark, *National Income*, p. 7.

[2] Sir M. Visvesvaraya's estimate of the annual cost of planning operations is ten crores.

In the field of Development proper, the biggest single item of expenditure will be on Education. Universal literacy will be the ideal. After some years, no child of school-going age should remain illiterate in India. One-seventh of the population now represents the proportion of children in India between the ages of 6 and 11, fit for a course of elementary education, extending to *four* years. A fifth of this number, will, on various grounds, be outside schemes of compulsory education. The maximum financial provision for universal Primary education will therefore be that required for only one-ninth of the population. Excluding the costs of buildings, equipment, inspection and direction, and on the basis of the estimates furnished by the Hartog Committee,[1] the total recurring cost of bringing all boys and girls of school-going age under instruction, will be about twenty crores a year. The estimate claims to be liberal, and may be held to cover the necessary overhead costs as well.[2] But no universal primary education is at present possible without compulsion and central control. Stagnation and relapse into illiteracy are the chief forms of educational wastage. Parental apathy is the principal impediment to the spread of primary education. If the schooling is inefficient and incomplete, and the pupil relapses into illiteracy, the indifference of the parent will harden into hostility. A thorough reorganisation of elementary education, which will avoid such wastage, must therefore precede the application of universal compulsion. It may not be possible, in the initial years, to expend the full grant for primary education. In such cases, the unexpended balances must be free to accumulate against future

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1 *Report*, pp. 269-271.

2 Mr. R. Littlehailes in the *Quinquennial Review of Education in India*, 1922-27, 1929, Vol. I, para. 205, puts the aggregate cost of permanent literacy at Rs. 58 crores!

calls. Any big increase in the grants to secondary and University education will have to await the approach to wide-spread literacy, and to a general improvement in the State's finances. For the same reason the raising of the age of compulsory schooling, and special grants for vocational and industrial training must be limited to the normal funds available.

The expenditure on Education will, to some extent, be a preparation for the control and eradication of preventible disease. The familiar devices of visual instruction by the Lantern and Motion pictures, as well as of Broadcasting, have great possibilities in educating the masses on the principles of health and on the ways of fighting disease and dirt.

Rural reconstruction will be on a secure basis only if there is a simultaneous movement against illiteracy and disease. Co-operation is now stereotyped, and has become a mere credit movement. It requires to be vivified, and to be used not only to extinguish debt, but to add to rural incomes, by exploiting through a suitable organisation of cottage industries the vast amount of unemployed time and man-power in the villages.

The additional expenditure to be provided for in a Planned scheme will thus amount to forty to fifty crores of rupees in all, *i.e.*, between a sixth and a fifth of the present aggregate expenditure now incurred by Central and Provincial authorities.

The New Resources.

(*a*) *From Constitutional Progress.*

If the sources of Indian revenue were elastic, the provision of so small a percentage of increase will not be difficult. But, in spite of the belief that taxation in India has not yet approached the limits of taxable

capacity, the tax burden is *felt* already as unduly heavy. The piling up of additional taxes is always difficult, and is not unattended with risk. It is one of the penalties attending a form of Government like that which exists to-day in India, that the rift between the Government and the people steadily widens with the imposition of additional taxation. Financial and political issues are intermingled. The need to avoid friction in raising the necessary additional public revenue may justify, even if it does not inspire, measures designed to bring about a favourable reaction in the mind of the taxpayer by extending the area of Responsible Government, to prove that the resources collected from the people are expended by and for them.

(*v*) *From Retrenchment and Rationalisation.*[1]

To what extent the additional financial pressure can be met by stringent economy and by the rationalisation of the fiscal system, it is impossible now to forecast. The Indianisation of the remaining highly paid services, and the application of the 'axe' to the bigger emoluments, are not expected to yield more than *two* crores a year. The 'rationalisation' of the working of administrative departments may result in a little saving, and in a decided increase in their efficiency. In the Commercial departments, it might lead to higher *net* profits, even if the prices at which their commodities and services are sold to the consumer are lowered on public considerations. The Defence budget is popularly supposed to be capable of a big contraction, without re-duction in either the strength or the efficiency of the

[1] The general lines of retrenchment are the abolition of unnecessary appointments and sinecures, the reduction wherever possible of additions to pay disguised as 'allowances', the substitution of honorary for paid workers, the simplification of administration, devolution and the restriction of appeals.

Army.[1] Rapid Indianisation of the ranks, and the gradual substitution of larger auxiliary forces for the regulars should, even without a reduction of the British contingent, result in savings. The manufacture of military stores and supplies; and of Arms and Munitions of war in India, must bring in some further saving, besides the indirect advantages to industrial development and to labour.

(*c*) *From State Undertakings.*

Of the possible additional income from an extension of State activities to the fields of Insurance, Banking and Industry, it is impossible to make any quantitative estimate owing to the dearth of data. But, it is certain that it will steadily grow.

(*d*) *From Taxation.*[2]

The cost of Planning has thus to be met chiefly from taxation.[3] The accentuation of progression, and the adoption of suggested improvements in the Income and Corporation taxes are estimated to yield together *seven* crores annually. An additional income of about *five*

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1 This is denied. See articles "officially contributed" in February-April, 1934, on the *Indian Army Budget.*

2 It would be of interest to summarise the financial proposals of Prof. C. N. Vakil, for purposes of comparison. They include: the removal of inequalities in the assessment of the land tax, and the regulation of re-settlements by statute, the further steepening of the rates of progression in the Income-tax and super-tax, the raising of general import duties from 15 to 20 per cent., the raising of the duties on articles of luxury from 30 to 40 per cent., and on cigar and cigarettes from 75 to 100 per cent., and the enhancement of the duty on manufactured tobacco from Rs. 2-4-0 to Rs. 3 per pound, the raising of the export duty on jute to 25 per cent., the imposition of an export duty on shellac, the restoration of the reduced duty on hides and skins, the extension of the entertainment tax to the whole country, the imposition of a succession duty and the levy of a tax on marriages.

3 The cost includes that of the operation of the plans, which Sir M. Visvesvaraya puts at 10 crores a year (*Planned Economy for India,* 1934, p. 295).

crores may be expected if agricultural income is brought under the Income-tax, even retaining the Permanent Settlement. The equalisation of the Excise and Customs duties on kerosene is estimated to bring in a *crore,* and the Excise duty on lac *another* crore, if the competition of synthetic lac will allow of the imposition. If even half the amount, which the cotton excise duty yielded comes from its restoration, the State will obtain an additional revenue of nearly five crores. In a country like India, where longevity is lower than in Western countries, the operation of the Inheritance tax might bring in an income, which is difficult to estimate correctly, but is believed to be unlikely to fall below five crores. The duty on tobacco, even if the rates are lower than those which are now imposed in some Indian States, might yield about ten crores. There are a number of other taxes, whose inclusion among the Scheduled Taxes will enable the Provincial Governments to utilise them, whenever necessary. The aggregate *additional* income, even without recourse to such devices as the enhancement of the Salt-tax or of the Customs duties, will amount to about thirty-six crores a year. The gap between the additional expenditure and income will then be only between five and fifteen crores, a sum not too large to be met gradually by normal increases, or to be financed by special loans,[1] which could be wiped out by the general prosperity brought in their train by wholesale improvements.

Practicability and urgency of Planned Finance.

Such estimates are obviously conjectural, but their meaning and drift may be clear. They point to the

[1] For the capital outlay implied in his ten-year scheme, Sir M. Visvesvaraya estimated the loans required at 500 crores. (*Op. Cit.*, p. 297.)

practicability of a Planned Development, spread over a period of a score of years, in a rationalised fiscal and administrative system. They may dispel the misgivings, which have impeded the formulation and execution of comprehensive Development and Welfare Schemes. After the Crown took up the direct administration of India, political ideals and motives replaced the mixture of political and commercial motives on which the East India Company had acted. The date when this occurred marks the dawn of the New Era in India: In respect of the arid wastes of economic and social depression to be overcome, the condition of Japan in 1860 was much worse than that of India. The unequal progress and record of the two countries since then has been used to support an indictment of British Rule in India, and to prove the rejuvenating effects of national freedom.

The Political Issue.

The present relative backwardness of India is attributed to her dependent political status, and to the unusual character of the constitutional relationship between Great Britain and India, which comes under no known political category. The hesitancy, which has characterised the State's attitude towards proposals for mass education in India, and for Welfare work through public agency and from the public funds, is also being compared, to the disadvantage of Great Britain, with the remarkable progress reported to be in process of achievement in a more backward area, under conditions of appalling discouragement, by the Soviet Republic. In the movement against social depression, private effort in India is now in advance of the State. This is an advantage, as it will create an atmosphere favourable to the reception of Government schemes for a big drive against social backwardness. In a recent study, the

success of the Soviet in the reclamation of "inferior sub-human people", within a period of less than a decade, is described, in a manner to stir up emulation in India. Through the Institute of Northern Peoples at Leningrad large numbers of adult students from the backward regions of Russia are said to have been educated and returned to their homes, "as apostles of modern ideals, after being taught in their own languages and trained in occupations suited to their native environment" [1]

The Goal.

The lesson of such experiments to India lies in the value of State intervention in the reduction of the social residuum, in welfare activity and in economic development generally, in the broadest sense of the terms, on a scale proportioned to the magnitude of the tasks to be accomplished, and through considered schemes which disclose both vision and courage. The inauguration of such policies will mark the beginning of a new era in India's history, in which the modernisation of life will proceed with the conservation of culture and tradition, and policies, which are abreast of the humane movements of the day will be envisaged as the goals of public effort, that will recognize the obligations to the past and to the future as no less imperative than to those of the present.

The co-ordinated action of all the different forces now working for India's uplift will be required for the successful pursuit of these aims. It can spring readily enough when the old tendency to regard the Government and the people as on opposed sides disappears, and the strength and prestige of a State are *felt* to depend on the existence of mutual trust between the Government and the people. Before such convictions can be

[1] M. I. Cole, *Twelve Studies in Soviet Russia,* 1933, pp. 133-39.

generated, the stigma of subordination and inferiority must disappear in the relation of India to Britain, and India must obtain a status and a power to control her economic policies, to regulate her arrangements for defence, and to determine the ways in which she will seek self-realization, while remaining a willing, contented, and zealous member of the greatest empire of History. India's autonomous position within the circle of Dominions must be stabilised by the conviction of the advantages she derives therefrom, in protection and in prestige, in guidance and in service, and in the maintenance of continuity of policy and economic growth. In the progress to this goal, Indian political agencies must learn to subordinate minor differences to the acceptance of broad principles of economic advantage and social justice, to incorporate economic ideals in their party creeds, and to educate the people in correct notions of political and economic duty. Not the least of the obligations which will lie on the administrations and party leaders of the country in the coming years is their duty to assimilate the principles on which the prosperity of nations depends, and to secure for such truths the widespread support, which will come from the appreciation of the aims and trends of modern Public Finance as among the effective instruments to promote India's lasting prosperity.

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